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This report presents a comprehensive review on

“The Evaluation of Monetary Policies in 2002 and Policy Directions

for the year 2003”. A preliminary version of this material was

presented to the House of Representatives and the public

through the media on January 9, 2003, pursuant to Article 58

of the Act Number 23 of 1999 on Bank Indonesia

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Vision :

"To be recognized, domestically and internationally,
as a credible central bank through the strength of our values
and achievement of low, stable rates of inflation"

Mission :

"To achieve and maintain price stability by maintaining
monetary stability and by promoting financial system stability
for Indonesia's long term sustainable development"

Values :

"Competence, Accountability, Integrity, Cohesiveness,
Transparency"

Symbols, Reporting Period, and Source of Data

r	Revised figures
*	Provisional figures
**	Incomplete figures
. . .	Data are not yet available
-	Not available
x	Figures in before and after mark could not be compared
- -	Nil or less than the last digit
$ (dollar)	United States Dollar
BI	Bank Indonesia
US	United States

Reporting period is January 1, 2002 to December 31, 2002
Source of data is Bank Indonesia unless mentioned otherwise

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BOARD OF GOVERNORS OF BANK INDONESIA

As of December, 31 2002

Sitting from Left to Right :
SYAHRIL SABIRIN, *Governor.* **ANWAR NASUTION,** *Senior Deputy Governor.*

Standing from Left to Right :
AULIA POHAN, *Deputy Governor.* **MAMAN H. SOMANTRI,** *Deputy Governor.* **MIRANDA S. GOELTOM,** *Deputy Governor.*
ASLIM TADJUDDIN, *Deputy Governor.* **MAULANA IBRAHIM,** *Deputy Governor.* **BUN BUNAN E.J. HUTAPEA,** *Deputy Governor.*

Foreword

In praise of God the Almighty, allow me to present Bank Indonesia's Annual Report for the year 2002. This report is one of the manifestations of Bank Indonesia's accountability as regulated in Article 58, Act 23 of 1999 concerning Bank Indonesia. The report presents policy measures that have been adopted and their results in the monetary, banking and payment system areas during 2002 as well as Bank Indonesia's policy directions for 2003. The developments and problems that have arisen in the Indonesian and international economies during the reporting year and the prospects for those economies in 2003 are also included in this report.

In 2002, our efforts to exit from the economic crisis yielded favorable results, although progress has not been as rapid as expected. *In the financial sector, the bank restructuring program has borne some fruit. Banks' soundness has improved, allowing banks to expand credits and channel funds in other forms, so that bank intermediation has gradually recovered. In the fiscal sector, various efforts to reduce subsidies and to reduce the burden of government domestic and foreign debts have provided some room for the Government to stimulate the economy. Supported by firm and wise actions by the Government in handling cases of separatism and terrorism in the country, socio-political tensions and security concerns in several areas of conflict have abated. Consistent monetary and fiscal policies—supported by stable political conditions, improved security and progress in economic restructuring—helped achieve economic and monetary stability during 2002.*

Monetary conditions throughout 2002 were quite stable and under control as indicated by developments in the rupiah exchange rate, inflation and base money, which allowed significant interest rate reductions*. On average in 2002, the exchange rate appreciated by 10% accompanied by lower volatility than in the previous year. This appreciation caused various parties and the mass media to nominate the rupiah as the best performing currency in Asia for 2002. Concerns in many* *quarters that the Bali bomb tragedy of last October would precipitate a sharp, sustained drop in the rupiah, proved to be unfounded. Supported by reduced inflationary expectations on the part of the public, the inflation rate declined from 12.55% in 2001 to 10.03% in 2002, after increasing during the two previous years. This outcome for 2002 was only slightly above Bank Indonesia's target range of 9%-10%. As mentioned, these stable monetary conditions provided room for Bank Indonesia to gradually lower key interest rates. During 2002, the 1-month SBI rate declined by 469 basis points, from 17.62% at the end of 2001 to 12.93% at the end of 2002. This was followed by reductions in other interest rates.*

***These positive macroeconomic developments provide hope for an acceleration of the Indonesian economic recovery in the years ahead**. Although not ideal, this positive climate was an opportunity for banks to restructure their credits, strengthen their capital, and extend more credits. Over the course of 2002, commercial banks expanded credits in the amount of Rp79.4 trillion, up from Rp56.8 trillion in 2001. Around 41% of these new credits in 2002 were channeled to the micro-, small- and medium-sized business sector (UKM). Another favorable development in this area concerns the surge in sharia banking as measured by the number of banks; size of the branch network; total assets; third parties funds; and total extended financing. In the meantime, lower deposit rates increased investor interest in holding bonds. In the real sector, stable monetary conditions provided a conducive business climate for firms to restructure their internal financial condition and helped the public to maintain its level of consumption. Lower interest rates also encouraged reputable corporations to seek alternative sources of finance from the financial markets, both at home and abroad.*

***Despite this progress, there are still many challenges that need to be addressed in order to accelerate economic recovery in 2003.** These challenges are related to the problems that had contributed to the slow recovery of real activity in 2002, with economic growth reaching only 3.7%. On the external side, global economic prospects are forecast to improve in 2003 but they are accompanied by heightened uncertainty. Other challenges faced by Indonesia have also grown, for instance, China joined the WTO; new regional competitors have emerged; and implementation of AFTA started this year. On the internal side, various structural problems that stood in the way of more economic progress in 2002 (particularly issues associated with law enforcement, regional autonomy and employment), are still forecast to limit the growth of investment and exports in 2003. Moreover, socio-political tensions are expected to rise in advance of the 2004 General Election. These various external and internal problems are also forecast to limit efforts to improve bank intermediation.*

Amid these challenges, Bank Indonesia is of the opinion that the prospects for economic growth in 2003 are better than last year. *Stable macroeconomic conditions are forecast to continue this year, which should nurture optimism among business agents and encourage further bank intermediation. Also, stronger fiscal stimulus and a resumption of delayed major projects would have a multiplier effect on various economic sectors. Nonetheless, the economic recovery would still be limited in its coverage. Most notably, growth in 2003 would continue to depend upon consumption while investment and exports would start to show positive growths but at insignificant rates. Overall, economic growth in 2003 is forecast to be within the range of 3.5%-4.0%.*

Optimism in economic prospects is also evidenced by plans of most banks to expand their credits in 2003. *However, banks' opportunities for credit expansion seem to be limited by the performance of the corporate sector. The only available solution is to explore the small- and medium-sized business sector (UKM) as the focus for credit growth. To make the most of such opportunities, domestic banks plan to raise their ceiling on new credits to the UKM sector, from Rp30.89 trillion in 2002 to Rp42.3 trillion in 2003.*

Monetary stability is forecast to continue in 2003. *The rupiah exchange rate is predicted to appreciate a little and fluctuate narrowly within a range of Rp8,800-Rp9,200 per US dollar. Fundamentally, stability of the rupiah is partly supported by the balance of payments, which is forecast to be in surplus. Nonetheless, there are several downside risks concerning the exchange rate, especially the possibility of rising political tensions before the 2004 General Election and a potential depreciation of regional currencies (due to flight-to-safety considerations) if the US attacks Iraq. For its part, inflationary pressure in 2003 is forecast to be lower than last year, supported by a relatively strong exchange rate and declining inflationary expectations. The main source of inflation in 2003 would continue to be government prices and incomes policies.*

To strengthen macroeconomic stability, Bank Indonesia will make efforts to reduce the inflation rate gradually according to the medium-term inflation target of 6%-7% by 2006. *Efforts in this regard would support reduced inflationary expectations on the part of the public. In line with macroeconomic prospects for 2003 and this medium-term inflation target, Bank Indonesia's Board of Governors has set the 2003 inflation target at 9% with a deviation margin of plus/minus 1 percentage point. Base money growth consistent with this inflation target would be roughly 13%. Further in this regard, continued declines in interest rates are possible as long as they do not disturb exchange rate stability or attainment of the inflation target. To support attainment of the* *inflation target, Bank Indonesia will be consistent in undertaking the requisite policies in areas of monetary, banking and payment system.*

This is a brief description of economic performance in 2002 and the economic prospects and Bank Indonesia's policy direction for 2003. A longer description is provided in the remainder of this report, which is intended to serve as a useful reference for readers.

Finally, on behalf of Bank Indonesia's Board of Governors, I wish to express my thanks to Bank Indonesia's management and staff who have worked hard and professionally during 2002 in assuming the mandate of Act 23 of 1999. I also wish to express my gratitude to parties outside Bank Indonesia who have supported and cooperated with Bank Indonesia. May God the Merciful bless us all and lighten our steps to a better future.

Jakarta, February 2003

Governor of Bank Indonesia

Syahril Sabirin

CHAPTER 1

Annual Report

Overview

CHAP-

1 OVERVIEW

The stable monetary conditions during 2002 have led to a decreasing trend of CPI inflation down to 10.03%, only slightly above the inflation target of 9%-10%.

During 2002, Indonesia's economy developed quite favorably as indicated by more stable macroeconomic conditions. Consistent monetary and fiscal policies, supported by progress in several aspects of economic restructuring, helped to achieve economic and monetary stability throughout the reporting year. The exchange rate strengthened significantly with relatively little volatility; base money was under control and below its indicative target; and other monetary aggregates, M1 and M2, increased, *albeit* at a slower pace than in 2001. These positive developments lowered inflation in 2002, a notable shift from increases in the two previous years. Improved inflation prospects, controlled base money and a stable and stronger exchange rate provided room for an easing of monetary policy with a gradual but steady reduction of interest rates, thereby delivering positive signals regarding the economic recovery.

During the year, SBI rates declined significantly from 17.62% to 12.93%. The exchange rate appreciated by a considerable amount, 10.10%, to an average level of Rp9,316 per dollar. Base money grew by 9.1%, lower than the indicative target of 13%-14%. Such favorable monetary conditions caused CPI inflation to trend downward to 10.03% during 2002, slightly above the target of 9%-10%. Declining inflationary pressures during the reporting year were reflected in the downward trend of core inflation[1] to 6.96%. This is consistent with Bank Indonesia's anti inflationary stance built upon a medium-term target of 6%-7% inflation by 2006.

Stable monetary conditions in 2002 strengthened the economic climate as reflected in improved expectations of the business community towards economic recovery. The positive climate was also an opportunity for the banking sector to re-build its internal condition through credit restructuring and strengthening of its capital structure. An expansion of bank credits resulted although not yet by as much as expected. In the business sector, a general decline in interest rates has given businessmen some reason for optimism in the prospects for recovery; lower rates also provided an opportunity for the corporate sector to restructure its financial condition. In the face of limited bank financing, these conditions have provided wider room for reputable corporations to find alternative financing through bond issuance, both domestically and abroad. In the private household sector, declining interest rates favored continued growth in consumption.

Nonetheless, economic results were constrained

1 Core inflation is calculated using exclusion method. This approach excludes commodities under the administered prices and volatile food in the CPI basket. Volatile food including items in the CPI basket with fluctuations, among others: rice, breed chicken meat, beef, red chili, small and hot chili, cooking oil.

by certain structural problems, so that the Indonesian economy was not fully responsive to the improved financial climate. High risks in the real sector (prompted by structural weaknesses, such as legal uncertainty, uncertainty in investment regulations due to regional autonomy, labor issues, and security factors) limited the growth of investment and exports.

Burdened by such structural problems, overall growth of the Indonesian economy in 2002 was 3.5% and was largely driven by consumption. Growth in investment and exports was still quite limited. On the external side, export performance was hindered by the weak global economy, rising competition from other Asian countries in attracting foreign investment and declining Indonesian competitiveness. Nonetheless, success in foreign debt restructuring (private and government) caused Indonesia's overall balance of payments to improve in 2002.

Looking ahead, prospects for recovery of the Indonesian economy are expected to improve slightly in 2003, with economic growth forecast to be around 3.5%-4%. Various risks and domestic uncertainties, such as the run up to the 2004 General Election, should be monitored carefully. The ongoing weak global economy and negative international perceptions of security conditions in Indonesia will put pressure on exports and limit foreign capital inflows and investment. Consequently, the prospects for the Indonesian economy in 2003 are expected to depend largely upon the performance of consumption. Dependence upon consumption has been typical of the Indonesian economy since the financial crisis of 1997, and it is not ideal since such growth is unsustainable. Consequently, various efforts are needed in order to improve investment and exports. These comprise a series of steps to overcome the structural problems noted above, through financial and structural policies that improve incentives in areas such as taxes, labor, and security.

The inflation rate is forecast to decline slightly in 2003. From the demand side, inflationary pressures are forecast to be insignificant, reflecting moderate economic growth. For their part, inflationary pressures originating in the exchange rate pass-through are forecast to be weaker than in 2002, in line with a stronger exchange rate, although there is a risk of depreciation before the General Election. By contrast, inflationary pressures originating in the impact of government policy on prices and incomes will remain high, despite some moderation from previous years. Against this background, Bank Indonesia sets a CPI inflation target for 2003 that is considered to be quite realistic according to forecast economic conditions, namely 9% with a 1% margin of error.

To reach this inflation target, monetary policy will be aimed at controlling the expansion of base money through the absorption of excess bank liquidity according to the real needs of the economy. Accordingly, Bank Indonesia sets a target for the growth of base money of 13%. Achieving this target is expected to lower interest rates because bank liquidity is still quite loose. Operationally, monetary control is to be conducted by optimizing the available instruments, especially through open market operations and partially sterilized foreign exchange intervention in order to reduce pressures on the exchange rate and inflation. In the banking sector, Bank Indonesia's policies will be aimed at strengthening banking resilience, improving banking infrastructure, and speeding up bank intermediation, mainly by promoting production and investment in the real sector. Finally, payment system policies are aimed at realizing an efficient, effective and safe payment system as well as protecting financial system stability from possible systemic failures.

EVALUATION OF THE INDONESIAN ECONOMY IN 2002

Macroeconomic Conditions

In line with improved macro-monetary indicators such as the exchange rate, inflation and interest rates, the Indonesian economy continued to recover in 2002. However, economic growth was only 3.7% and it had an unbalanced structure. This unbalanced structure of growth was reflected in the large continuing dependence of economic growth on consumption (Table 1.1). In addition, exports and investment (which were initially predicted to improve in 2002) actually contracted during the reporting year. Imports also declined significantly, mainly imports of raw materials and capital goods. On the labor front, the moderate economic growth of 3.7% is estimated to absorb only 0.8 million workers, out of 1.7 million new entrants into the labor force last year. Consequently, open unemployment reached 9.1 million, representing an (open) unemployment rate of 9.1%.

On the demand side, consumption grew appreciably, despite its earlier prediction to slowdown over the previous year. Private consumption grew by 4.7% during 2002, while government consumption grew by 12.8%. The growth in private consumption was driven in part by a significant increase in minimum wages early in the year and by an increase in consumer financing extended by both banks and non-bank financial institutions. On the side of government consumption, high growth mainly stemmed from reduced subsidies, which made room for government consumption to increase. Most government consumption was for personnel and routine regional spending.

Investment, which had been predicted to improve in the second half of 2002, turned out to be unfavorable. For the year as a whole, it contracted by 0.2%, much lower than in 2001 (7.7%) and in 2000 (13.8%). Lower investment was consistent with weaker construction activity and lower imports of capital goods (such as machinery and equipment). It was also consistent with a drop in the value of both foreign and domestic investment approvals, 35.3% and 57.0%, respectively. From the financing side, weak investment was reflected in limited bank investment credits. On the external side, exports dropped by 1.2%, much lower than the growth of 1.9% in the previous year.

Low investment and exports are inherent in the high investment risk and deteriorating competitiveness of the Indonesian economy due to the structural problems, mentioned earlier. In addition, investment and exports were hurt by the weak global economy, more intense global and regional competition and on-going protectionism in several countries. In line with this, imports also declined, by 8.3%

On the output side, all economic sectors ex-

The Indonesian economy grew by 3.7% and was largely consumption driven.

(Percent)

Table 1.1
Selected Macroeconomic Indicators

Item	2000	2001	2002
Gross Domestic Product	4.9	3.4*	3.7**
By Expenditure			
Consumption	3.9	4.8	5.5
Household Consumption	3.6	4.4	4.7
Government Consumption	6.5	9.0	12.8
Gross fixed capital formation	13.8	7.7	-0.2
Exports of goods and services	26.5	1.9	-1.2
Imports of goods and services	21.1	8.1	-8.3
By Sector			
Agriculture	1.9	1.0	1.7
Manufacturing	6.0	4.1	4.0
Electricity, gas and water	7.6	7.7	6.2
Trade. hotel and restaurants	5.7	5.3	3.6
Tranportation and Communication	8.6	7.3	7.8
Finance. leasing and service companies	4.6	3.4	5.6
Moneter Aggregate			
M2 growth			
- Average	9.88	14.74	8.05
- End of Period	15.60	12.99	4.72
M1 growth			
- Average	22.67	19.76	9.85
- End of Period	30.13	9.59	7.99
Base Money Growth			
- Average (test date)	18.62	17.85	9.06
- End of Period	22.28	9.47	5.97
Interest Rate			
SBI (1 month)	14.53	17.62	12.93
Interbank Money Market (overnight)	14.22	15.90	12.42
Time Deposit (1 month)	11.96	16.07	12.81
Working capital credit	17.65	19.19	18.25
Investment credit	16.86	17.90	17.82
Inflation	9.35	12.55	10.03
Balance of Payments			
Current Account/GDP	5	4.7	4.0
Debt service ratio (DSR)	41	39.7	32.2
Foreign currency reserves in months of non-oil/gas imports	6	6.1	6.4
Average Exchange Rate (Rp/$)	8,403	10,255	9,316

Sources: - BPS-Statistics Indonesia
- Bank Indonesia

panded in 2002 with transportation and communication as well as electricity, gas and clean water recording the highest growth of 7.8% and 6.2%, respectively. By contribution to growth, the 2002 economic growth was mainly accounted for by manufacturing, transportation and communication, trade, hotels and restaurants. Despite making the largest contribution to overall growth, manufacturing's pace of expansion virtually unchanged in 2002 to 4.0% from 4.1% in 2001.

Transportation and communication was also directly affected by the Bali tragedy, although it still grew appreciably by 7.0%. This high growth was due to the transportation sub-sector as reflected in rising numbers of airline passengers due to lower ticket prices. As regards the communication sub-sector, growth largely originated in private investments in telephone companies and cellular telephone operations.

As noted, the trade, hotel, and restaurant sector contributed significantly to economic growth, although it, too, recorded lower growth of 3.6% in 2002. The lower growth was mainly due to the Bali tragedy, which disrupted activity in the hotel and restaurant sub-sector during the last 3 months of the year. Agriculture sector recorded a higher growth mainly due to improved productivity and expansion of arable land, while the negative impact of El Nino threat was ill founded.

On the fiscal side, implementation of the government budget during 2002 reflected financial consolidation to ensure medium-term fiscal sustainability. However, the deficit narrowed much more than expected, mainly due to very low realizations of development spending. The fiscal deficit for 2002 is estimated at 1.7% of GDP, lower than the budget target of 2.5%. On the revenue side, the tax ratio reached only 12.7% of GDP, mainly due to the under-performance of non-oil/gas income taxes and the VAT. Shortfalls in these tax revenues were offset by higher oil/gas revenues in line with the increase in world oil prices and other non-tax revenues. The overall revenue was 18.0% of GDP or roughly the same as the budgetary target.

On the spending side, the realization of routine spending was below target eventhough domestic debt servicing exceeded the target, because domestic interest rates exceeded budgetary assumptions. The realization of development spending was below target due to low absorption capacity of foreign loans, especially for project loans. Realization of the regional budget did not face significant constraints and was roughly on-target. Total realized spending was 19.7% of GDP, or 4.7% lower than the initial target.

As regards the impact of government spending on the economy, the fiscal stimulus was the same as last year, namely 11.8% of GDP. Of this stimulus, 7.0% of GDP was in the form of consumption and 4.8% of GDP in the form of investment. By contrast, transfer payments (mainly subsidies) declined significantly, from 5.2% to 2.4% of GDP. On the monetary side, government rupiah spending was quite conducive to supporting monetary control. The net expansionary impact of government spending declined from Rp32.2 trillion last year to Rp19.5 trillion. Bank Indonesia was able to absorb this amount, due to a net inflow of foreign exchange from the government sector equivalent to Rp24.3 trillion.

On the external side, Indonesia's overall balance of payments (BOP) improved, due to a wider current account surplus and a narrower capital account deficit. The improved current account was mainly due to better export performance; in the case of the capital account, it was mainly due to successful foreign debt restructuring.

Despite improved exports, several constraints remained. There was a decline in Indonesia's export competitiveness; a weak global economy; and intense global competition. Low competitiveness was reflected in a lower share of Indonesian exports in destination countries, while the share of major competitors, such as China, increased. On the internal side, exports were constrained by security and labor issues, which caused several companies to relocate their operations. As a result, non-oil/gas exports reached only $45.3 billion in the reporting year, up by only 1.0% from 2001. Oil/gas exports reached $12.7 billion, representing a rise of 1.3%. Total imports increased by 0.5% to $34.8 billion; oil/gas imports increased by 15% while non-oil/gas imports declined by 2.4%.

The deficit on the services account is estimated to be $15.9 billion in the reporting year, virtually unchanged from 2001 ($15.8 billion). The Bali tragedy, which reduced inflows from tourism, was roughly offset by lower foreign interest payments and by lower oil sector payments in line with a lower volume of oil production. The overall surplus in the current account in 2002 was estimated to reach $7.3 billion (3.9% of GDP), higher than the pervious year's surplus of $6.9 billion (4.7% of GDP).

For its part, the capital account improved with the rescheduling and restructuring of debt and inflows on private account. The success of the government in rescheduling debts through the Paris and London Clubs contributed appreciably to the narrower (by $0.6 billion) deficit on the official capital account. The deficit on the private capital account narrowed significantly in line with the success in debt restructuring, and inflows from privatization and divestment. There were also inflows of capital due to renewed access to the international bond market by reputable domestic corporations. These positive developments caused the deficit on private account to narrow to $3.0 billion, compared with $8.3 billion in the previous year. Hence, the deficit on capital account narrowed to $3.6 billion from $9.0 billion last year. On this basis (and considering the wider surplus on current account, noted earlier), the overall balance of payments was in a surplus of $3.6 billion, much better than the previous year's deficit of $1.38 billion. With this surplus, official international reserves reached $31.6 billion by the end of 2002, equivalent to 6.6 months of imports and government debt service.

and Bank Niaga. Positive sentiment was also reflected in declining swap premiums at all tenors. The 1-month swap premium declined from 16.8% at the end of 2001 to 12.5% at the end of 2002. Also, the US dollar depreciated against the yen due to the weak US stock market, various financial scandals involving several large American corporations and a decline of the Fed Funds Rate by 50 basis points. The stronger yen impacted on most currencies in the region, including the rupiah.

Significant strengthening of the rupiah and weak aggregate demand helped put inflation on a downward trend in 2002, as reflected in both CPI and core inflation. CPI inflation during 2002 declined to 10.03%, versus 12.55% last year; core inflation was down to 6.96% from 10.04% in the previous year. Inflationary pressures originated in, among others, government policy on prices and incomes. These pushed up prices by 3.31%, compared with 3.83% in 2001. In addition, inflationary pressure originated in supply shocks, mainly reduced food supply and disruptions to the distribution network due to floods early in the year. Another factor was public inflationary expectations, which generally improved in 2002 as shown by several surveys. However, since QIII-2002, inflationary expectations have been on the rise, largely due to reduced fuel subsidies and increases in other administered prices by the government; a mild tendency for rupiah depreciation; and seasonal factors associated with religious festivities.

The Exchange Rate and Inflation

The appreciation of the exchange rate and the ongoing weak aggregate demand caused inflation to trend down.

During the reporting year, the rupiah exchange rate appreciated noticeably and exhibited greater stability. This was supported by improved fundamentals; regional and sentiment factors; and by Bank Indonesia intervention to reduce fluctuations. On average, the rupiah appreciated by 10.10% in 2002, from Rp10,255 to Rp9,316 per dollar; on a point-to-point basis, it appreciated by 16.2%, from Rp10,400 to Rp8,950 by the end of 2002.

Concerning fundamentals, the appreciation was driven by a shift in the balance of payments from a deficit to a surplus. Regarding market sentiment, the stronger rupiah was supported by positive sentiment driven by success in debt rescheduling; disbursements of the IMF loan; up-grading of Indonesia's debt rating by Fitch and Standard & Poor's; and the implementation of privatization and the divestment of BCA

Monetary Policy and Developments

Monetary Policy

Monetary policy in 2002 was aimed at absorbing banks' excess liquidity and lowering interest rates to send conducive signals and improve the supply side of the real sector. Operationally, the strategy of monetary policy was to optimize the available monetary instruments; open market operations (OMO) and foreign exchange intervention/sterilization were used to absorb excess liquidity in the context of a declining trend in SBI rates. This strategy was undertaken as long as it did not induce inflationary pressures that might eventually cause inflation to exceed Bank Indonesia's target.

Monetary conditions were encouraging since early in the reporting year. Base money was quite stable and under its indicative target; the exchange rate was stronger and on a rising trend, which reduced inflationary pressures. These conditions provided room for Bank Indonesia to gradually lower interest rates, while taking into account the real interest rate and interest rate differentials. This policy of lower interest rates was undertaken in line with efforts to revive bank intermediation and to raise public confidence in the prospects for economic recovery. This strategy is expected to encourage agents to restructure their finances and to take advantage of available financing resources (from both banks and the capital market) to raise their utilization and productive capacity.

In implementation, this strategy was undertaken by observing developments in inflation, the exchange rate, base money and real interest rates from quarter to quarter. In QI-2002, Bank Indonesia took careful note of the high level of base money at the end of 2001 and the predicted re-inflow of currency into the banking system after the annual religious festivities. Accordingly, Bank Indonesia absorbed bank liquidity through a combination of OMO instruments and foreign exchange intervention/sterilization, so as to reduce base money below its indicative target. This strategy was successful and simultaneously lowered the SBI rate by 86 basis points to 16.76% by the end of the first quarter. The FASBI[2] rate did not change during this period, which indicated a neutral bias. Care was taken to be sure that inflation and the exchange rate did not deteriorate.

In QII and QIII-2002, the continued appreciation of the exchange rate, the downward trend of inflation and base money growth under its indicative target provided room for Bank Indonesia to strengthen signals of lower interest rates (an accommodative policy). The FASBI rate was reduced four times during this period (by a total of 250 basis points) from 15.13% to 12.63%. This decline supported a lower SBI rate, which was down to 13.22% by the end of QIII-2002.

During QIV-2002, the strategy of monetary policy shifted slightly from an accommodative stance to a neutral bias. This shift was based on indications of higher inflationary expectation associated with a weakening of the exchange rate after the Bali tragedy and a sufficiently low SBI rate for achieving the medium-term inflation target. However, in reality the impact of the Bali tragedy on the exchange rate was temporary, and not as severe as predicted; the rupiah rebounded quickly. The strengthened rupiah and improved inflationary prospects encouraged Bank Indonesia to lower the FASBI rate by 50 more basis points

2 FASBI stands for Fasilitas Simpanan Bank Indonesia or Bank Indonesia Deposit Facility. FASBI is a monetary instrument replacing the Rupiah Intervention aimed at absorbing banks' excess liquidity. Prior to November 2002, FASBI is known as contractive rupiah intervention.

for all tenors by end-November. During 2002 as a whole, monetary policy lowered 1- and 3-month SBI rates by 469 basis points and 451 basis points to a level of 12.93% and 13.12%, respectively, by year-end.

Improved inflation developments and a stronger exchange rate in 2002 improved the public's expectations concerning inflation and monetary stability, and encouraged a lower precautionary demand for currency. Improved socio-political conditions contributed to lower demand for currency in 2002, which was the main cause of reduced base money growth during the reporting review. On average, base money growth was 9.06% in 2002, far below last year's 17.85% and significantly under its indicative target of 13%-14%. Reflecting base money developments, the growth of M1 and M2 also declined, from 19.76% and 14.74% in 2001 to 9.85% and 8.05% in 2002, respectively.

Lower SBI rates have lowered deposit rates, but have not been able to lower lending rates.

Transmission of Monetary Policy

In general, the accommodative stance of monetary policy (indicated by declining rates on monetary instruments) was successful in lowering deposit rates, but lending rates have not changed as expected. The declining rates of monetary instruments significantly reduced the interbank money market (PUAB) rate, and this was followed by a downward trend in deposit rates (though not as sharp as the drop in SBI rates). The weighted average 1-month deposit rate declined by 326 basis points, to 12.81% level. This decline was also associated with a decline in the maximum guarantee rate of 355 basis points, which in part was driven by a reduction in the margin of the guarantee rate by 200 basis points.

In line with lower nominal deposit rates, the real deposit rate also declined, to 2.78%. Significantly lower real deposit rates have promoted aggregate demand by stimulating consumption. The strategy of lowering interest rates when the exchange rate was appreciating sent positive signals concerning the real economy and improved investors' perceptions as evidenced by lower risk premiums and surveys conducted by Bank Indonesia.

The response to lower deposit rates was different for different lending rates. The rate on working capital began to decline in QII; by year end, it was down 9 basis points to 18.25%. The rate on investment credits which increased since early 2002 until October, also began to decline. In part, this indicated the time lag in responding to a decline in rates on monetary instruments. However, the slow limited response in investment credit rates was also due to high banking risk in extending longer term credits. High risks caused banks to be very cautious in expanding their lending, as reflected by the low growth of outstanding investment credit. On the demand side, the low growth of investment credit also reflected high credit risk faced by the business sector. By contrast, the rate on consumer credit increased by 36 basis points from 19.85% to 20.21%. Despite higher rates, the volume of consumer credits continued to rise significantly through the reporting period, in part reflecting the reorientation of bank credits from the corporate to the retail sector.

Although declining interest rates have not impacted real sector activity as much as expected, this policy has had a favorable effect by shifting business and corporate financing from bank into bond financing. With declining time deposit rates and limited long-term credit financing from banks, reputable corporations saw opportunities to issue bonds. On the placement side of funds by customers, lower bank deposit rates have caused bonds and mutual funds (reksa dana) to emerge as attractive, alternative sources for funds placement.

Banking Policy and Developments

Continuing the banking policy pursued last year, in 2002 Bank Indonesia focused on three programs, namely bank rehabilitation, banking resilience, and bank intermediation. Under the banking rehabilitation program, the government continued to implement the guarantee program although the guarantee coverage will be gradually eliminated. While under the bank recapitalization and credit restructuring (which have been implemented during the last few years), Bank Indonesia continued to monitor developments.

With regards to strengthening banking resilience, efforts were aimed at improving the banking infrastructure, enhancing the quality of bank management and strengthening prudential regulations. One critical, priority action to improve banking infrastructure is the plan to establish a deposit insurance institution (Lembaga Penjaminan Simpanan or LPS) in place of the existing guarantee scheme. In this regard, Bank Indonesia in cooperation with the Government has made preparations for establishing this LPS, including preparing the legal basis and plans for an efficient deposit insurance scheme. The deposit insurance scheme would be efficient in the sense that it seeks to reduce moral hazard as much as possible while maintaining the momentum of current improvements in public confidence vis-a-vis the national banking system.

In the area of banking supervision and regulation, the aim is to meet international standards as defined by the 25 Basel Core Principles. Improvements in this regard covering risk-based supervision, including incorporating market risk in calculating banks' capital adequacy. With more complex banking products and services in more intense economic globalization, improvements to the banking system are vital. In this regard, Bank Indonesia is preparing a Blue Print of Indonesian Banking Architecture with the objective of creating a future banking system that could face change and guarantee financial system stability. To promote financial stability, Bank Indonesia is preparing a Blue Print of Financial System Stability covering the tasks of Bank Indonesia in promoting financial sys-

> To anticipate future banking development and to enhance financial system stability, Bank Indonesia is developing an Architecture of Indonesia's Banking System and Financial System Stability.

tem stability, and a coordination framework for crisis prevention and resolution. Internally, Bank Indonesia prepared organizational aspects of the monitoring and surveillance of financial system stability.

To promote bank intermediation, several steps should be undertaken, mainly in the form of incentives to expand credits especially to small-medium scale business which is considered to have driven economic growth to date. In this regard, efforts include the Micro Credit Project, Development of Integrated Information Systems for Small Scale Business, and efforts to match business agents with the banking sector (known as Bazar Intermediasi) in several regions. In order to revive the economy in several regions, particularly in conflicting areas/regions, Bank Indonesia has provided special criteria to measure the quality of credit channeled to the micro sector and small-medium business enterprises (UKM) operating in those areas. In addition, as support for elimination of poverty, Bank Indonesia has cooperated with the Office of the Coordinating Minister of People's Welfare to encourage banks to expand credit to the low-income segments of society.

The policy to strengthen banking resilience was also implemented through the development of banks operating under sharia principles. In this field, a number of initiatives and strategic steps have been taken. During 2002, the Blue Print of Sharia Banking Development in Indonesia was completed. This will point the direction for sharia banking development in the future. It will also provide guidance for Bank Indonesia, the sharia banking institute and other sharia financial institutions to develop a competitive, efficient sharia banking system while adhering to cautious principles and encouraging the real sector through financing based on quasi-equity principles. According to the blue print, priorities in 2002 are complementing and improving sharia banking regulations, enhancing public understanding, strengthening the infrastructure and promoting international cooperation in sharia banking systems. In line with the strong interest of the conventional banking sector to open sharia bank offices or change their status into sharia banks, Bank Indonesia has issued a regulation regarding this issue. In the forum of international cooperation, Bank Indonesia has been active in promoting the International Islamic Financial Market (IIFM) as an institution to develop sharia money market instruments; and the Islamic Financial Services Board (IFSB), which makes sharia banking regulations and supervision.

The many policies mentioned above, supported by improved macro-monetary conditions, have strengthened the banking system. This was reflected in a stronger capital structure, improved NPLs, stronger profitability and a recovery in bank intermediation. As regards capital, a stronger capital structure is reflected in the system-wide CAR, which reached 22.49% at the end of 2002, 1.9% higher than the previous year. Banks' efforts to restructure credit have reduced their gross NPL ratio to 8.3% (2.9% on a net basis), as compared to 12.1% (net 3.6%) a year previously. Although the overall net NPL ratio is below 5%, there were still 20 banks with a net NPL ratio above 5%. From the side of profitability, banks' net interest income has risen by Rp42.9 trillion (compared with Rp37.8 trillion in the previous year) reflecting a wider spread between credit and deposit rates due to lower SBI rates.

Rehabilitation of banks, supported by macro-monetary conditions, have promoted bank intermediation, although it has not yet recovered as much as expected. Improved intermediation was reflected in higher outstanding bank credits, which rose by 17.4%. However, by composition, the highest growth was recorded by consumer credit (36.5%). Working and investment credits increased by only 13.8% and 11.3%, respectively. This indicated that banks are very cautious, preferring to extend short-term credits due to continued perceptions of high long-term credit risk. Looking at new credits, the amount of credit channeled by banks during 2002 reached Rp79.4 trillion, substantially above 2001 (Rp56.8 trillion). Since most of the corporate sector is still restructuring, banks were focusing largely on the retail and UKM sectors, as indicated by the larger amount of credit channeled to these sectors. Of the new credits extended during 2002, 41.1% went to the UKM sector.

National Payment System Policy and Developments

To improve economic activity and efficiency, Bank Indonesia continued its efforts to maintain a stable and efficient payment system. As regards the non-cash payment system, policies in 2002 focused on lowering risks and enhancing efficiency. To enhance efficiency, the BI-RTGS system expanded; the nominal cap on credit notes processed through clearing was lowered; the transaction costs of BI-RTGS were adjusted; automated image clearing was introduced in the Bandung and Medan branch offices; and the intercity clearing system was implemented. As regards lowering risk in the payment system, policies undertaken during 2002 include: the creation of a mechanism to overcome failure to settle; a regulation to execute a card-based business payment system; and the drafting of a law on Funds Transfer. Internally, lower payment system risk was undertaken by establishing a Payment System Supervision Division in Bank Indonesia. At the strategic level of reducing risk, Bank Indonesia is reviewing a Blue Print Payment System, dated 1995. To meet international standards on the payment system front (as defined by the BIS in the Core Principles for Systematically Important Payment Systems), Bank Indonesia defined BI-RTGS and the Clearing System as systematically important systems. In this regard, Bank Indonesia has comprehensively reviewed the compliance of those two systems with those BIS principles; several items that did not meet international standards, have been improved.

Certain payment system policies (mainly efforts to expand the RTGS system and to lower the cap on credit notes processed through the RTGS) have significantly increased RTGS activities. The daily average of nominal RTGS transactions increased by 21.3%, and the number of daily transactions soared by 105.8%. By contrast, and in line with higher RTGS activities, daily clearing activity declined by 23.8%. Concerning card-based payment transactions, the use of ATM cards, debit cards, and credit cards rose significantly. This stemmed from an expanded ATM network, more outlets using debit cards, and rising consumer financing through credit cards.

As regards the cash payment system, Bank Indonesia's priority policies in 2002 were to meet the public's needs for currency, maintain the quality of currency in circulation, and minimize counterfeiting. As regards meeting the need for currency, several steps have been taken such as improving the Currency Distribution Plan and expanding cooperation with third parties in distributing small denomination notes and coins in the Jabotabek (Jakarta-Bogor-Tangerang-Bekasih) region. The public's need for currency was reflected in the amount of currency in circulation, which rose by 11.8% on average during 2002. By type of currency, the ratios of banknotes and coins in 2002 did not change much, namely 97.76% for banknotes and 2.24% for coins.

In addition to providing adequate currency, Bank Indonesia maintains the quality of currency to standards that are fit for circulation. This is done through a clean money policy that operates by withdrawing and destroying notes that are no longer fit for circulation (known as Pemberian Tanda Tidak Berharga/PTTB). Nominally, the number of PTTB notes during 2002 was Rp54.1 trillion, which is up by 62.33%.

To maintain the quality of notes and simultaneously enhance the efficiency of currency distribution, Bank Indonesia has reviewed alternatives for metal content and standardization of coins. The objective is to obtain coins' metal content with lower intrinsic than face value, but with an extended circulation period.

To minimize counterfeiting, several preventive and repressive steps have been taken. Preventive efforts have strengthened security features that allow the public to easily identify rupiah notes by sight and feel. Also, Bank Indonesia has provided information on how to identify authentic money through posters and stickers, seminars, and advertisements in the public mass media. Repressive efforts emphasized cooperation among associated institutions in combating counterfeit money. These institutions include BOTASUPAL (the Coordinating Board for Eradication of Counterfeit Money) and the National Police in catching and processing those who are involved in counterfeiting crimes. During 2002, discoveries of counterfeit money (by banks, the Police, and Bank Indonesia) amounted to 370,112 notes in the value of Rp9.9 billion, which is a major increase from the previous year (98,028 notes in the value of Rp3.9 billion).

ECONOMIC PROSPECTS AND POLICY DIRECTIONS FOR 2003

Evaluation of economic performance in 2002 indicates that a number of positive developments provide hope for a stronger economy in 2003. Improved monetary indicators and macroeconomic stability will be maintained in 2003, which hopefully will increase the optimism of agents concerning economic recovery. However, a number of external factors and structural problems cause the real sector to respond slowly to the improved monetary indicators, which has hindered the recovery. Overcoming various risks and uncertainties is the key to ensuring better prospects in the coming year.

World Economic Prospects

Macroeconomic stability is forecast to promote 2003 economic outlook, mainly if supported by structural policies in the legal, labor and investment fronts.

During 2003, the world economy is forecast to grow by 3.7%, up from an estimated 2.8% in 2002.

This improvement would stem in part from a higher volume of international trade, which is forecast to expand by around 6.1%. It will also be supported by expansionary monetary and fiscal policies in several countries. In the industrialized countries, economic growth is forecast to improve slightly, despite slower growth in the US, Japan and Europe (2.6%, 1.1% and 2.3%, respectively). Among the developing countries, growth is forecast to remain higher than in the industrialized world. In 2003, Africa, Asia, ASEAN, and Latin America are forecast to grow by 4.2%, 6.3%, 4.2%, and 3.0%, respectively. Improved growth in these regions is mainly driven by higher domestic demand supported by expansionary macroeconomic policies, mainly in countries with low inflation.

In line with higher aggregate demand induced by expansionary macroeconomic policies, world inflation rate will generally remain quite moderate. The inflation rate in developed countries is forecast to rise from 1.4% to 1.7%; in developing countries, it is expected to rise from 5.6% to 6%. With continued expansionary policies, interest rates will decline, mainly at short-term maturities.

The rise in non-oil/gas commodity prices during 2002 is forecast to continue in 2003. Rising commodity prices will mainly take place in agricultural products and raw materials for manufacturing in line with expanding demand. The world oil price is forecast to rise especially when the US attack on Iraq is to take place.

Macroeconomic Prospects

Improved macroeconomic indicators are forecast to continue next year and these will strengthen agents' expectations and hasten the recovery of bank intermediation. Fiscal stimulus and a resumption of large projects will have a multiplier impact on a number of sectors. Overall economic growth in 2003 is forecast to be around 3.5%-4.0%, a bit higher than in 2002. This growth is within the range of the 2003 state budget assumption.

From the demand side, this growth is projected to be consumption driven. Declining interest rates and low leverage of private household are forecast to induce further expansion of consumer credit, mainly to the mid-upper class. Increased consumption is further supported by higher civil servant salaries and provincial minimum wages. Investment should expand, but at an insignificant rate. Government investment should increase significantly, mainly due to a re-start of various delayed projects (such as 21 toll road, electricity and chemical projects). Private investment is forecast to remain weak due to limited financing and other unfavorable investment climate. Exports are forecast to rise in line with improved economies of trading partners and increased demand for major Indonesian commodities (e.g., oil palm, rubber and other agribusiness products). This will be supported by government policies in seeking out non-conventional markets such as Latin America and Eastern Europe. Imports are also forecast to rise, in line with higher exports and overall economic growth.

By sector, growth is forecast in all economic sectors with electricity, transportation (mainly the telecommunications sub-sector) and construction recording the strongest performances. In line with the government plan, already noted, to resume a number of infrastructure projects, the construction and electricity sectors are forecast to expand rapidly. These will have a large multiplier effect on other sectors, increasing overall growth and absorbing labor. In the construction sector, property development (mainly housing and shopping centers) is also forecast to expand appreciably, spurring growth in the steel and cement industries. In the electricity sector, the development of new power plant and the continuation of several private power projects (in anticipation of rising demand for electricity in 2003 and beyond), will add to growth. Manufacturing (which contributed the most to growth in 2002) is forecast to accelerate in 2003. Growth in other sectors (such as trade, transportation and communications, and services) will be lower than last year, owing to the impact of the Bali tragedy. In the case of the communications sub-sector, growth will be sustained somewhat by expansion of Indosat and Telkom.

On the fiscal side, the 2003 state budget aimed at controlling the deficit while taking into account the negative impact of the Bali incident by accommodating a strong public interest in fiscal stimulus. The budget deficit is forecast to be 1.78% of GDP, virtually unchanged from the preliminary realization for 2002 (1.75% of GDP). Control of the 2003 deficit will be achieved through a continued increase in budget revenues (mainly tax collections) and through belt-tightening (largely cuts in oil/gas subsidies) and lower domestic debt servicing. On the financing side, government financing still originated in domestic non-bank sources—such as privatization and IBRA assets sales—with the balance supplied by foreign borrowings. However, since the net contribution from these sources is small relative to overall needs, the government plans—for the first time since the 1997 crisis—to use savings of the monetary system (Sisa Anggaran Lebih; SAL) in the amount of Rp8.5 trillion. As regards to the impact of government spending on the economy, the direct contribution of the government sector to GDP would increase over last year, from 11.9% in 2002 to 13.43% in 2003, of which 7.7% of GDP is for consumption spending and 5.7% for investment spending. As mentioned earlier, this increase is to be achieved mainly through significant cuts in fuel subsidies and reductions in domestic debt servicing. On the monetary side, the additional allocation for fiscal stimulus has caused rupiah budgetary expansion of Rp26.7 trillion. Most of this amount is forecast to be financed by net foreign exchange inflows from the government sector which reach Rp18.2 trillion; the remainder will be a withdrawal of Rp8.5 trillion from the SAL.

In 2003, the Indonesian Balance of Payments is forecast to weaken compared with the previous year. The overall surplus will narrow to $1 billion from $3.6 billion in 2002, due to a smaller surplus on current account and a larger deficit on capital account. The decline of $2.6 billion in the current account surplus will mainly be accounted for by a rise in the deficit on services of $2.3 billion, mainly due to declining receipts from tourism related to the Bali tragedy. On the trade account, exports and imports are forecast to grow by 1.3% and 2.8%, respectively in 2003 and the trade surplus will narrow by around $0.2 billion. The deficit on capital account will widen slightly in 2003, from $3.6 billion to $3.7 billion, largely due to a larger private capital account deficit ($2.6 billion). On this basis, official foreign exchange reserves are forecast to reach $32.6 billion at the end of 2003, equivalent to 6.7 months of imports and official foreign debt service payments.

The Exchange Rate and Prospects for Inflation

In general, the exchange rate is forecast to remain strong in 2003, although it will not strengthen as sharply as in 2002. It is expected to fluctuate within the range of Rp8,800 to Rp9,200 per dollar. Looking at economic fundamentals, the predicted exchange rate is founded upon an improved performance of the Indonesia's economy, including the balance of payments which remains in surplus, albeit more narrowly than in 2002. Other factors supporting the stronger exchange rate are: success in (official and private) debt restructuring; privatization of state-owned enterprises; and divestment of IBRA assets, which add to the supply of foreign exchange and provide positive sentiment. In addition, the market's positive views regarding Bank Indonesia's commitment to maintaining exchange rate stability is expected to continue. However, some possible developments need to be monitored cautiously, including higher political tensions prior to the General Election of 2004 and regional weakening of currencies as a consequence of flight to safety should the US attack Iraq.

Inflationary pressures in 2003 are forecast to ease from 2002. There will be limited pressures from aggregate demand, a stronger exchange rate and lower inflationary expectations. One source of inflationary pressure will be the impact of increases in administered prices and government incomes policies, which are estimated to remain substantial, although less so than in 2002. Low inflation originating in aggregate demand pressure is supported by the 2003 forecast for consumer-driven economic growth. Also, the Bali tragedy has weakened investor optimism regarding exports and the investment climate. In light of the forecast for a somewhat stronger rupiah in 2003, the overall exchange rate will not put pressure on inflation. By contrast, government policy on prices and incomes is forecast to contribute 3.02% to inflation in 2003, mainly due to higher administered prices, such as the Base Electricity Tariff (6% per quarter), fuel (around 23%), telephone tariffs (15%), and provincial minimum wages (7%).

Banking Prospects

In line with growth prospects and declining interest rates, Indonesia's banking sector is also forecast to improve in 2003. Mobilization of funds from third parties is expected to rise, especially in the form of demand and saving deposits. However, time deposits are forecast to be in tough competition with mutual funds (reksa dana), since the return on reksa dana is higher than on time deposits.

In line with the rise in mobilized deposits, credits are forecast to rise, both in the form of corporate and retail lending. Surveys of 14 large (systematically important) banks indicate that credit expansion by those banks in 2003 is likely to reach Rp83 trillion. Other surveys showed that 40 banks will raise expansion of their credits on average by 5% over the year 2002. By usage, the rise in credit will be mainly extended for working capital and consumer credits; investment credit will not grow significantly. UKM credit is forecast to increase by around Rp40 trillion, since most banks have redirected their credit policy from corporate to retail operations.

The overall CAR is forecast to decline slightly, but remain above the 8% level. This decline will stem from higher risk-weighted earning assets in line with the expansion of credit. It should be noted that, although the industry-wide net NPLs ratio is forecast to remain below 5% in 2003, there are several banks with net NPLs above 5%, due to various constraints in their credit restructuring.

In 2003, the sharia banks are forecast to expand rapidly as in the previous year. This growth is mainly driven by high market demand for sharia banking and under-utilized regional potential. Optimism in this regard is further supported by plans of sharia commercial banks (and sharia business units in conventional commercial banks) to develop businesses, and by plans of new banks to enter the sharia banking industry.

Risk and Uncertainty Factors

Indonesia's economic prospects for 2003 will be strongly affected by a number of risks and uncertainties, both domestic and foreign. The main factors in this regard are:

- **First** on the external side, although the overall world economy is forecast to improve in 2003, there is also greater uncertainty. World economic growth in 2003 is largely contributed from within the Asian region. At the same time, growth in most industrialized countries (such as the US and Japan) is forecast to be moderate. Prolonged political tension in the Middle East will deteriorate global economic growth and have a large impact on world trade. This in turn will affect global investment climate and also worsen investors' perception on Indonesia's economic prospect.
- **Second,** from side of investor and foreign trade partners, negative perceptions of the Indonesian economy could intensify. This is based on various socio-political and security issues which deteriorated following the Bali incident. Also, international confidence will require a "war premium" on Indonesian trading activities. The premium will raise transaction costs of foreign trading partners and deepen the concern about investing in Indonesia.
- **Third**, and on the internal side, political and security conditions will be especially important in advance of the 2004 General Election. Despite continued improvements, developments in this regard contain uncertainties that could raise political instability. If these rise excessively, in the short-term it will weaken key variables, such as the exchange rate and demand for currency. This will also harm the real sector because of weakening consumer confidence and further deterioration in the investment climate.
- **Fourth,** on-going labor conflicts (characterized by strikes) could disrupt social harmony and raise business uncertainty. This issue has the potential to significantly raise the number of layoffs, and further reduce the interest of foreign parties in trading and investing in Indonesia. Furthermore, higher wages as a solution to labor conflicts will lower the competitiveness of Indonesian products, if they are not accompanied by higher productivity.
- **Fifth,** various unsatisfactory processes and settle-

ments of several large legal cases have hurt public perceptions of the supremacy of law in Indonesia. These cases damage global business confidence in the domestic investment climate, further reducing investor interest in Indonesia. Also, this reduces the government's credibility in its commitment to implementing good governance.

- **Sixth,** bank intermediation is proceeding more slowly than expected. Although credit expansion did improve in 2002, growth was still far below the needs of the real sector. The banks are reluctant to extend credit as reflected in the rigidity of credit rates in the face of lower SBI rates, and limited long-term financing is a barrier to investment as a source of growth.
- **Seventh,** in line with ending the IMF program at the end of 2003, an exit strategy should be carefully considered. On the one hand, a successful exit from the IMF program could maintain international confidence and re-establish independence in economic policy-making. On the other hand, failure to maintain discipline in fiscal and balance of payments issues without the IMF, will worsen prospects for the Indonesian economy.

Bank Indonesia sets the inflation target for 2003 at 9% with a 1% error margin

Inflation Target and Policy Directions for 2003

Inflation Target

Last year, Bank Indonesia put in place a medium-term program for reducing inflation to a target of 6%-7% by 2006. Since the target is supportive of economic recovery, annual inflation targets will be pursued during the next few years consistent with the medium-term target. A strong commitment to achieving this target is vital to lowering the public's inflationary expectations and to rebuilding Bank Indonesia's credibility.

In line with the medium-term target, Bank Indonesia sets the 2003 inflation target at 9% with a 1% margin of error. Hopefully, that target will be achieved if there is a continuing decline in inflationary expectations; the Rupiah exchange rate continues near Rp9,000 per dollar; economic growth reaches 3.8%; and government policy on prices and incomes contributes no more than 3.02% to inflation.

Policy Directions

Taking into account economic prospects, targeted inflation and various challenges encountered in 2003, Bank Indonesia will make consistent efforts to undertake sound policies in the monetary and banking sectors and the payment system.

In the monetary sector, Bank Indonesia policy will be consistently aimed at achieving CPI inflation of 9% in 2003 and maintaining its commitment to reaching the medium-term target of 6%-7% by 2006. In implementation, the monetary policy framework is achievement of a base money target. Therefore, in 2003 base money will be aimed at achieving average growth of around 13%, which is estimated to meet the real needs of the economy. The absorption of excess liquidity consistent with the base money target will allow interest rates to decline further.

In operation, the efficient use of monetary instruments will be continued in 2003, including efforts to use foreign exchange intervention and sterilization to help absorb bank liquidity and minimize excessive fluctuations of the exchange rate. On a long-term basis, treasury bills and government bonds need to be considered as alternative instruments. Therefore, efforts should be continued to develop infrastructure of the secondary market for securities, mainly to enhance their effective use as monetary instruments.

On the banking front, policies will be aimed at rebuilding the banking system and strengthening banks' resilience by emphasizing risk-based supervision. To strengthen the Indonesian banking system, Bank Indonesia is developing the Architecture of the Indonesian Banking System, which will be completed in 2003. This study covers six pillars, namely: creation of a sound banking structure; an independent and effective supervision system; a banking regulation system that is able to anticipate future banking; money market development; strengthening banking infrastructure; and consumer protection. To enhance the role of Bank Indonesia in maintaining financial system stability, Bank Indonesia is preparing a Blue Print for Financial System Stability covering: surveillance and monitoring of financial system stability; crisis resolution; and the organizational framework. In addition, Bank Indonesia continues to promote the recovery of bank intermediation, while maintaining cautious principles and promoting UKM. With regard to achieving maximum net NPLs of 5% by the end of June 2003, Bank Indonesia will require banks with net NPLs above 5% to make a clear and concrete business plans to get down to 5%.

In the sharia banking area, the policy direction during 2003 is aimed at improving the regulations and supporting infrastructure for sharia banking. On the regulation front, these improvements will largely cover risk- based supervision; prudential regulation and examination of the soundness of sharia banks; improvements in reporting systems; and accounting guidance and audits. Improved infrastructure covers the potential regions for sharia bank office expansion in order to expand the sharia office network.

In the payment system front, policies in 2003 will be aimed at strengthening the payment system through the promotion of efficiency and the elimination of payment system risk. Regarding the cash payment system, effectiveness of public money circulation will be improved through cooperation with third parties. Also, to prevent counterfeit money, networks with associated parties (such as the Police, Bank Indonesia branch offices, and other banks) will reach out to the village level, including socialization on the identification of authentic rupiah notes with security features that are easy to identify by sight and touch. On the non-cash payment system front, policies to reduce risk and enhance efficiency will emphasize: the implementation of BI-RTGS in 10 Bank Indonesia branch offices; regulations associated with card-based business activities; avoiding failure in clearing settlements; and the drafting of a law on Funds Transfer.

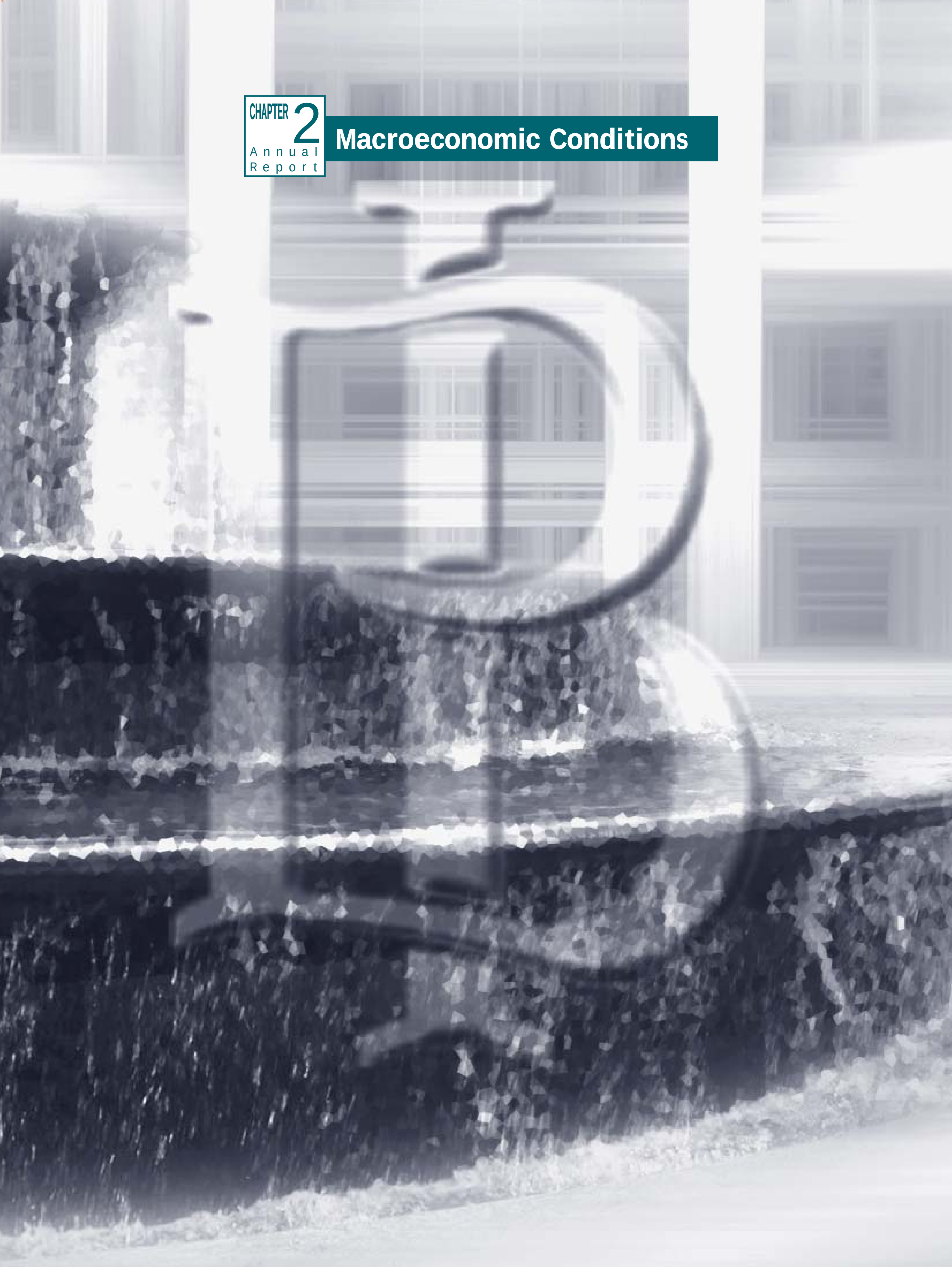
CONCLUSION

In conclusion, it should be noted that progress achieved in the economic and monetary areas during 2002 was often the result of good cooperation and coordination among macroeconomic, monetary and fiscal policies, supported by progress in the area of economic restructuring. In the future, such coordination needs to be promoted, especially under the anticipated circumstances of greater challenges and uncertainties. Experience in 2002 provided us a lesson that macroeconomic success in maintaining stability or in providing stimulus will never have a significant impact on the economy, if structural microeconomic problems (such as labor issues, taxation, investment safety and good governance) are not addressed. Therefore, handling structural problems and microeconomic policies should become the top priority as we look ahead.

In the meantime, Bank Indonesia will continue its internal transformation. This will enhance the effectiveness of monetary policy by reviewing monetary policy, by repositioning the role of Bank Indonesia in the maintenance of financial system stability, and by strengthening internal management through good governance in order to face the challenges and changes in the future.

CHAPTER 2
Annual Report

Macroeconomic Conditions



CHAPTER

2 MACROECONOMIC CONDITIONS

In 2002 the economy grew by 3.7%, higher than the previous year, but still without a balanced structure. The economy remains consumption driven; investment and exports have not yet become "engine of growth".

Overall, the Indonesian economy continued to recover in 2002, accompanied by several improved macro monetary indicators, such as inflation, the exchange rate, and interest rates. Gross Domestic Product (GDP) in nominal terms reached Rp1,610.0 trillion, and real GDP expanded by 3.7%, up from 3.4% in 2001. With that growth, the level of GDP in constant prices reached Rp426.7 trillion, which is still below real GDP in 1997 (Rp433.2 trillion). This indicates that the Indonesian economy has not fully recovered from the crisis that has been going on for the past five years.

Rising economic activity was reflected in higher private and public (government) consumption, while investment and exports have been weak. On the external side, exports contracted due to an on-going world economic slump, tougher competition in the global marketplace, declining competitiveness of Indonesian products and other constraints, such as trade shifts in line with the formation of trading blocks and rising protectionism.

On the supply side, all economic sectors expanded. The highest growth occurred in transportation and communications, electricity, gas and water, and financial sectors. The manufacturing and trade sectors, which hold the largest shares in GDP, both slowed. However, growth in these two sectors could be offset by growth in other sectors in raising GDP, as overall GDP recorded higher growth. While consumption still grew, the slowing growth of manufacturing was matched by an increased supply of imported consumption goods. This adequate supply of goods in domestic market created a tolerable demand pressure on prices.

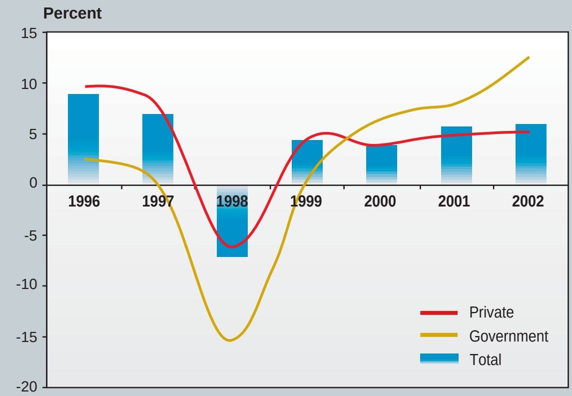
Declining investment caused economic capacity (especially in manufacturing) to slow down. At the same time, actual output did not increase significantly. Consequently, capacity utilization remained at a low level and was not a significant source of price pressure. These developments in production and investment indicated that improved monetary indicators have not yet had an impact on the real sector.

The moderate economic growth of 2002 was not sufficient to improve Indonesia's gloomy unemployment problem. Indeed, open unemployment increased because the number of new jobs did not match the increase in the labor force. In some sectors, reductions or shutdowns in production caused lay offs and increased unemployment. This difficult situation deteriorated further owing to the repatriation of a large number of illegal Indonesian workers from Malaysia, the economic impact of the Bali tragedy, and a mushrooming of labor demonstrations and strikes.

AGGREGATE DEMAND

GDP increased by 3.7% in 2002, up from 3.4% in the previous year (Table 2.1), but there was no improvement in the economic structure. On the domestic side, consumption remained the driving force of growth while investment declined. On the external side, net exports widened due to a sharp drop in imports that was larger than a contraction in exports.

Positive developments in several monetary indicators in 2002—such as lower inflation, a stable exchange rate and declining interest rates—have not yet borne fruit in the real sector. Lower interest rates seemed to boost consumption, but the response of investment—which has a bigger multiplier effect than consumption—remained weak. Continuing low investment also stemmed from other aspects of the unfavorable investment climate and the relatively high interest rate for investment loans. In addition, the stronger exchange rate with low volatility during the reporting year has not been able to boost production and investment, as well as export and import.



Graph 2.1
Consumption Growth

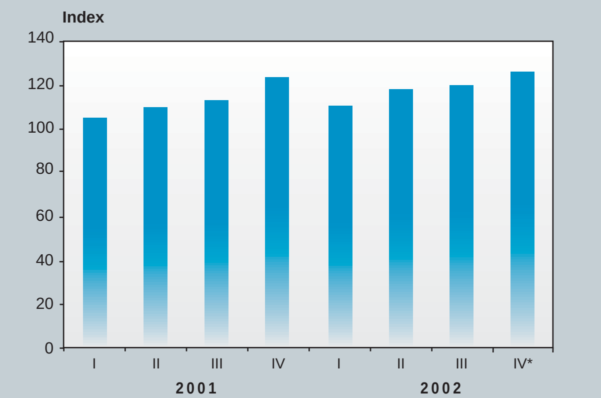
In 2002, the contribution of consumption to GDP growth was 4.3%, up from 3.7% in 2001. This was due to higher consumption growth in both the private and public sectors. The growth of private consumption spending increased from 4.4% to 4.7% in the reporting year; government consumption increased by 12.8% in 2002, substantially above the previous year (9.0%). The growth of public consumption has exceeded that of private consumption since 2000 (Graph 2.1).

(Percent)

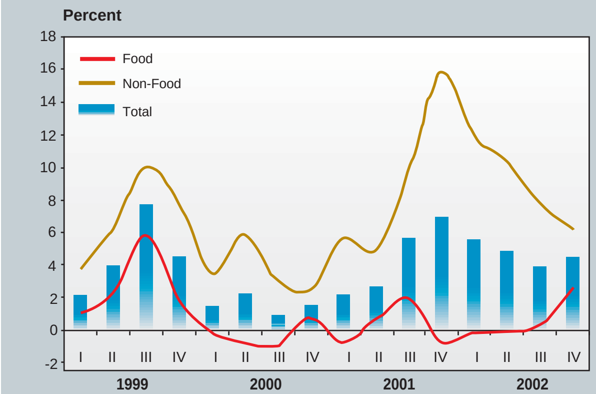
Table 2.1
Gross Domestic Product by Expenditures

Item	1999		2000		2001*		2002**	
	Growth	Contribution	Growth	Contribution	Growth	Contribution	Growth	Contribution
Gross Domestic Product (Real)	0.8	0.8	4.9	4.9	3.4	3.4	3.7	3.7
Consumption	4.3	3.3	3.9	3.1	4.8	3.7	5.5	4.3
Household Consumption	4.6	3.2	3.6	2.6	4.4	3.1	4.7	3.3
Government Consumption	0.7	0.1	6.5	0.5	9.0	0.7	12.8	1.0
Investment[1)]	-18.2	-4.5	13.8	2.8	7.7	1.7	-0.2	-0.1
Export of Goods and Services	-31.8	-11.4	26.5	6.4	1.9	0.6	-1.2	-0.4
Import of Goods and Services	-40.7	-14.3	21.1	4.4	8.1	2.0	-8.3	-2.2

1) Investment is gross domestic fixed capital formation
Source : BPS-Statistic Indonesia



Graph 2.2
Retail Sales Real Index

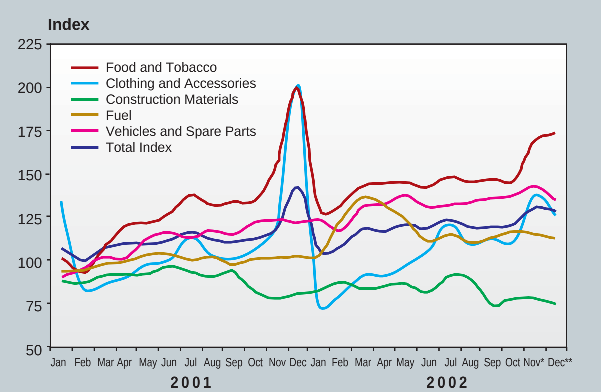


Graph 2.4
Private Consumption Growth

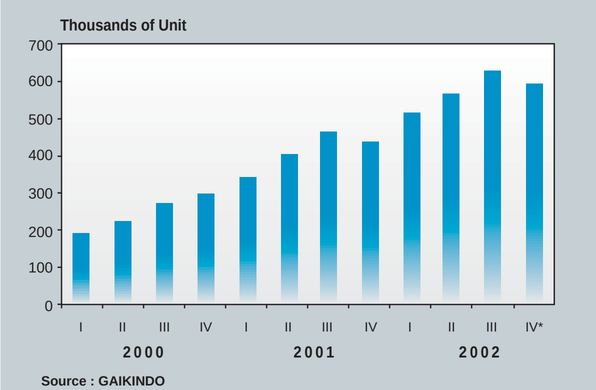
The rise in private consumption is reflected in several narrower indicators. In general, quarterly retail sales indexes increased in real terms to 126.2 in QIV-2002 (Graph 2.2).[1] There was a rise in almost all categories of goods surveyed (excepting only construction materials); the rise was mainly contributed by food and tobacco, vehicles and spare parts, clothing and accessories and home appliances (Graph 2.3).

Based on surveys, higher sales of food and tobacco were in line with the higher growth of consumption spending allocated for food, which increased from 0.3% in 2001 to 0.7% in the reporting year (Graph 2.4). Despite a slower tendency, 2002 annual growth in non-food consumption spending remained high, namely 9.0%. Other, confirming indications include non-commercial vehicle sales. Boosted by financing facilities, motor vehicle sales increased by 2.3 million units in 2002, which represents an increase of 39.5% over the previous year (Graph 2.5). Likewise, sales of vans and sedans reached 264 thousand units in 2002, which is up 5.1% over the previous year (Graph 2.6).

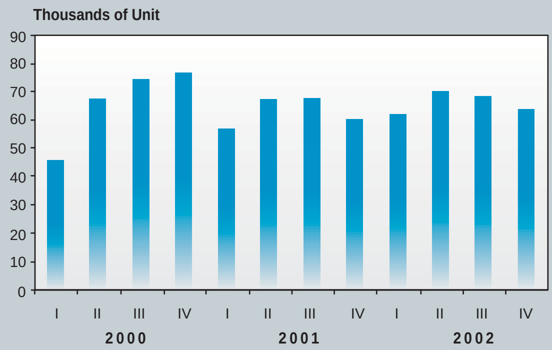
1 The Retail Sales Survey conducted by Bank Indonesia.



Graph 2.3
Retail Sales Survey

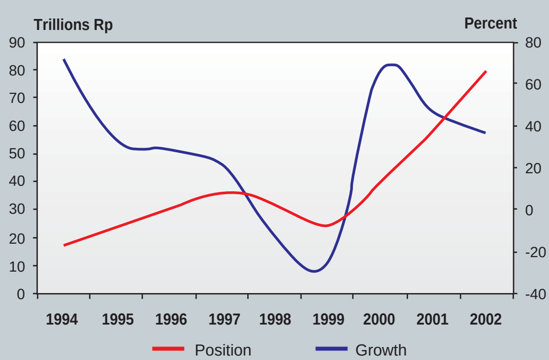


Graph 2.5
Motorcycle Sales

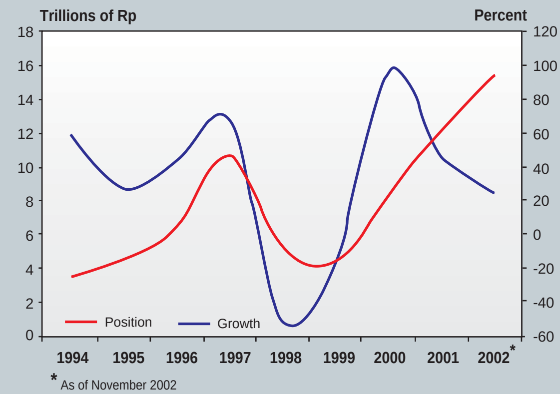


Graph 2.6
Car and Van Sales

This rise in private consumption spending was reflected in financing, both in credit from banks and from finance companies. Annual growth in consumer credit from banks remained high in 2002 (36.5%), although it did decline appreciably from 2001 (45.5%; Graph 2.7). A similar development was suggested by lending from consumer finance companies. The average growth of this form of consumer finance remained high, in line with lower interest rates. As of November 2002, it stood at 24.7%, a marked slowdown from the annual growth of 76.3% in 2001 (Graph 2.8). A similar pattern is suggested by development of the card payment



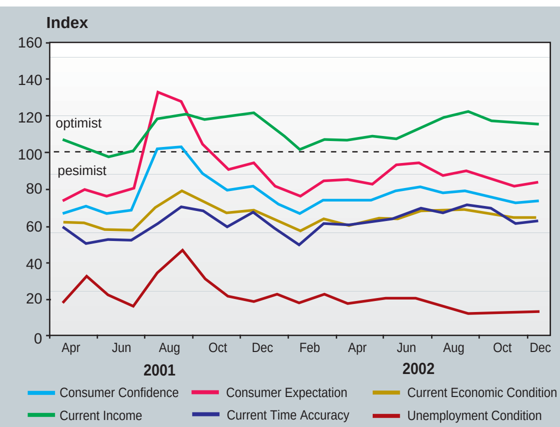
Graph 2.7
Consumption Credit



Graph 2.8
Consumer Financing

system. The use of credit cards as a means of non-cash transactions widened in 2002, as indicated by the number of credit card holders which reached 4.1 million people in November 2002, an increase of 18.4% over the previous year. However, growth of the volume of transactions came down sharply, from 41.9% in 2001 to 14.9% in 2002. Self-financing through the use of debit cards also declined. The number of debit cardholders declined by 4.8% in 2002, from 13.6 million people in 2001 to 12.9 million in the reporting year (Table 2.2).

Consumer surveys indicated that consumers remained pessimistic towards economic conditions as



Graph 2.9
Consumer Survey

Table 2.2
Card-base Means of Payment

	1998	1999	2000	2001	2002 a)
Credit Card					
Number of holder (people)	2,028,442	2,043,846	2,622,604	3,457,226	4,093,371
Transaction volume (trillions of Rp)	4.9	10.4	13.6	19.3	22.2
Transaction value per holder (millions of Rp)	2.4	5.1	5.2	5.6	5.4
Debit Card					
Number of holder (people)	5,374,376	12,110,970	13,103,676	13,587,505	12,930,161
Transaction volume (trillions of Rp)	2.6	3.2	4.7	6.7	7.5
Transaction value per holder (millions of Rp)	0.5	0.3	0.4	0.5	0.6

a) As of November 2002

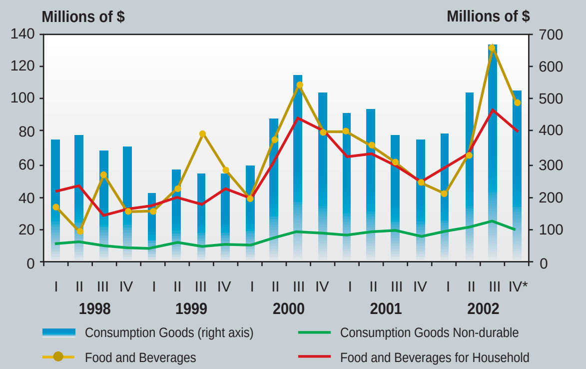
reflected, for example, in the Economic Conditions Index,[2] which remained below 100 throughout the reporting year (Graph 2.9). Consumer pessimism was also reflected in the Timely Durable Goods Index, which remained low, implying that the public continued to give priority to their purchase of basic non-durable goods, such as food and clothing. Consumers gave two main reasons why they did not buy durable goods, namely low incomes and high prices of those goods. These indicated a weaker public purchasing power from the income side, despite a sizable nominal increase in provincial minimum wages, effective 1 January 2002. In addition, various government pricing policies (to raise the price of fuel, the base electricity tariff, telephone rates, and transportation tariffs) further weakened the public's purchasing power. This condition was worsened by increasing unemployment.

Consumer pessimism was also reflected in surveys conducted by other institutions. The Consumer Tendency Survey conducted by BPS (the Central Statistics Bureau) indicated a recent shift in sentiment. Up to QIII-2002 the Consumer Tendency Index had been rising, but in QIV-2002 it declined below 100, indicating a general deterioration in consumers' prospects. The Consumer Confidence Survey done by the Dana Reksa Institute (DRI), exhibited a similar pattern; it was on a rising trend through September 2002, but subsequently fell below 100.

By source, rising consumption spending was accommodated by both domestic production and imports. Imported consumer goods increased by 12.7% in 2002, a sharp contrast from 2001 when they declined by 5.8% (Graph 2.10).[3] The rise in imports of consumer goods occurred in almost all components, such as food and beverages, food and beverages for households, and non-durable goods. Also, there was a mushrooming of imported agriculture products (such as rice and sugar) and an influx of manufactured products (such as clothing and electronics) into the domestic market. On one hand, this rise in imports provided more options to consumers and helped contain price pressures by increasing supply, especially of basic needs, such as rice and sugar. On the other hand, this phenomenon indicated the low competitiveness of domestic industry.

2 The Consumer Survey conducted by Bank Indonesia.

3 Source: Indonesia's Balance of Payments.



Graph 2.10
Import of Consumption Goods

Table 2.3
Domestic and Foreign Investment Approval

	2000	2001	2002
Domestic Investment			
Number of projects	355	264	181
Investment value (millions of Rp)	92,410.0	58,816.0	25,262.3
Foreign Investment			
Number of projects	1.524	1.333	1.135
Investment value (millions of Rp)	15,426.6	15,055.9	9,744.1

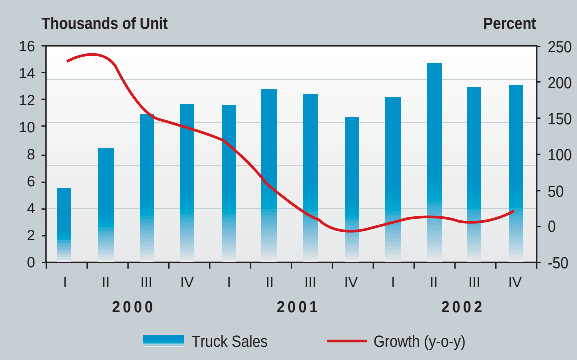
Source : BKPM

In the public sector, government consumption (National Accounts basis) rose significantly in 2002, by 12.8% compared with last year's 9.0%. This is due to declining government subsidies that make more room for higher government consumption (and investment) spending. Of the consumption spending, most of it was allocated for regional consumption in the form of General Allocation Funds, and Special Autonomy and Balancing Funds.

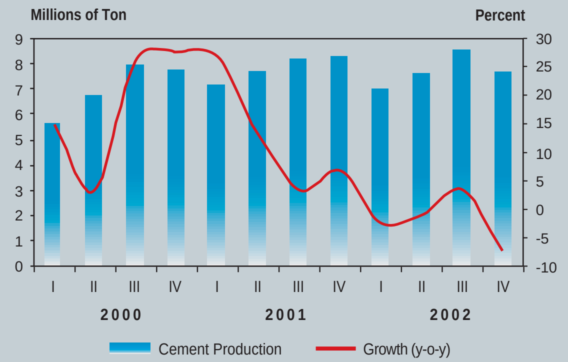
Investment, which had been forecast to improve in the second half of 2002, remained weak. For the year as a whole, it contracted by 0.2%, far below the results for 2001 (7.7%) and 2000 (13.8%). Low investment reflected high risks and deteriorating competitiveness brought on by labor disputes, the implementation of regional autonomy, legal uncertainty, and security concerns that were heightened by the Bali tragedy.

Other indicators of deteriorating investment include plunging (foreign and domestic) investment approvals and falling imports of capital goods and raw materials. The value of domestic investment (PMDN) approvals fell sharply by 57.0% in 2002, from Rp58.8 trillion (264 projects) in 2001 to Rp25.2 trillion (181 projects) in the reporting year. Similarly, foreign investment approvals dropped by 35.3%, from $15.1 billion (1,333 projects) in 2001 to $9.7 billion (1,135 projects) in 2002 (Table 2.3). Also, there were indications of a switch in foreign investment from manufacturing to trade, repair and other services, which have faster returns and lower sunk costs.

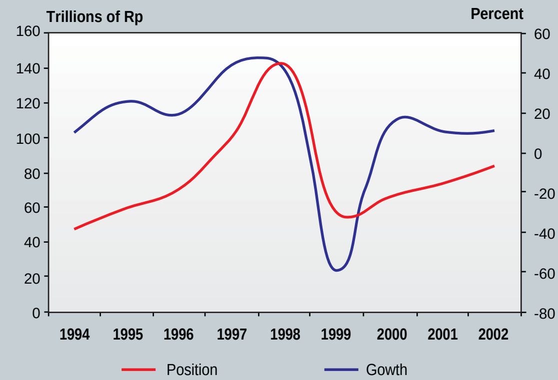
Weak investment was also reflected in various leading indicators, such as sales of trucks and production of cement. Although both increased, their growth moderated markedly. Average growth of truck



Graph 2.11
Truck Sales



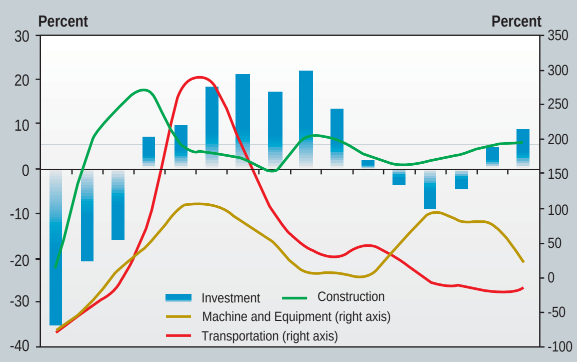
Graph 2.12
Cement Production



Graph 2.14
Investment Credit

sales came down from 43.3% in 2001 to 11.5% in 2002 (Graph 2.11), roughly in line with declining investment in the transportation sector. Average growth of cement production contracted by 1.8% in 2002, a stark contrast to growth of 12.6% in 2001 (Graph 2.12). The growth of cement production began to slow in the middle of 2001, although it did pick up around mid-2002. This development was in line with construction investment, which tended to slow in 2002, but improved a little towards year-end (Graph 2.13).

On the financing side, the share of investment credit in total bank credit declined from 24.0% in 2001 to 22.8% in the reporting year. Investment credit grew by 11.3%, little changed compared with 2001's 10.2% (Graph 2.14). By contrast, non-bank sources of finance (such as bonds) expanded appreciably, supported by declining interest rates. In the reporting year, 12 companies issued bonds with a total value of Rp5.3 trillion (Table 2.4).



Graph 2.13
Investment Growth by Type

Although the investment climate was not conducive, potential domestic financing for investment remained quite large. This reflected a large continuing

(Billions of Rp)

Table 2.4
Bond Issued in 2002

No.	Emitent	Value
1	Jasa Marga IX	400
2	Oto Multiartha I	300
3	Astra Sedaya Finance II	400
4	Pupuk Kaltim I	600
5	Perum Pegadaian IX	300
6	Bhakti Investama III	200
7	Telkom I	1,000
8	Federal International Finance I	300
9	Matahari Putra Prima	450
10	Indosat II	1,075
11	Bank Nagari V	200
12	Inti Visindo Internasional	100
	Total	5,325

Source : Surabaya Stock Exchange

saving-investment surplus (4.08% of GDP), although that surplus has narrowed since 2000. The narrower surplus was mainly due to a smaller surplus in the private sector; the deficit in the government sector declined slightly from 2.72% in 2001 to 1.66% in the reporting year (Table 2.5). The main factor contributing to higher government savings was reduced routine spending on fuel subsidies.

After consumption, the other large contributor to GDP growth in 2002 was net exports, which reached 1.8% of GDP. However, the larger share of net exports was due to a sharp contraction in imports that was more

(Trillions of Rp)

Table 2.5
Saving-Investment Gap

	1999	2000	2001	2002
	Current Price			
Government				
Saving	62.9	28.9	21.8	38,2[1)]
Investment	74.2	60.1	62.3	65,9[1)]
Deficit/Surplus	-11.3	-31.2	-40.5	-27.7
Private				
Saving	222.9	307.3	365.1	355.1
Investment	166.1	208.6	253.8	259.4
Deficit/Surplus	56.8	98.7	111.3	95.7
Total				
Saving	285.8	336.2	386.9	393.3
Investment	240.3	268.7	316.1	325.3
Deficit/Surplus	45.5	67.5	70.8	68.0
	% of GDP			
Government				
Saving	5.67	2.25	1.46	2.29
Investment	6.68	4.69	4.18	3.95
Deficit/Surplus	-1.02	-2.44	-2.72	-1.66
Private				
Saving	20.08	23.97	24.49	21.29
Investment	14.96	16.27	17.02	15.55
Deficit/Surplus	5.12	7.70	7.46	5.74
Total				
Saving	25.75	26.22	25.95	23.58
Investment	21.65	20.96	21.20	19.50
Deficit/Surplus	4.10	5.27	4.75	4.08
GDP	1,110.0	1,282.0	1,491.0	1,667.9[1)]
Current Account (in billions of $)	5.8	8.0	6.9	7.3
Average Exchange Rate (Rp/$)	7.850	8.438	10.255	9.316

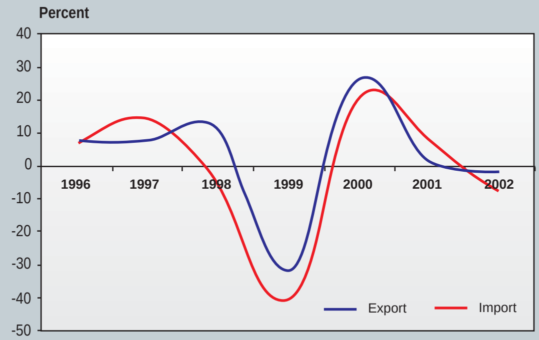
[1)] Government saving-investment and GDP (current price) based on realization of government budget

Source : BPS-Statistic Indonesia, Bank Indonesia and Ministry of Finance (processed)

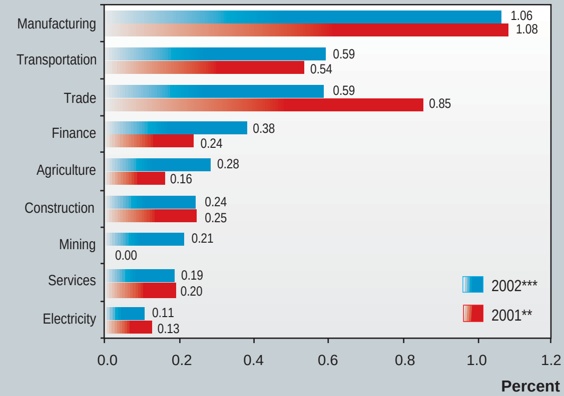
pronounced than the decline in exports of goods and services. After peaking at 26.5% in 2000, the growth of exports fell to -1.2% in 2002. This disappointing performance of exports was due to various problems of domestic and foreign origin. On the domestic side, export-oriented industries still faced a number of problems, such as: (i) legal uncertainties; (ii) a rise in production costs associated with higher telephone tariffs, and electricity and fuel prices; (iii) labor strikes and demands for higher wages; (iv) obsolete production technology due to declining investment; (v) a small market share and an inefficient distribution system; (vi) structural problems, such as the emergence of regional / local regulations that hinder the development of manufacturing and trade; and (vii) concerns over security.

On the external side, slow economic recovery in several countries—especially the main trading partners of Indonesia, like the United States and Japan—is a barrier to expansion of exports. The IMF's World Economic Outlook, which in early 2002 forecast US economic growth of 2.3%, revised their forecast down to 2.2%. Slow economic growth reflected consumer confidence, which touched its lowest level in the last 9 years. In Japan, economic contraction deepened in 2002 (0.5% compared with 0.3% in 2001). Unfavorable economic developments in Japan caused business confidence to slip, as reflected in the Tankan index, which was still negative in September 2002. This weak performance of these two big economic powerhouses has held back world economic recovery.

Several other problems hinder exporters, including: (i) intense global competition. China's membership in the WTO has became a great challenge for Indonesian producers; (ii) increased protectionism



Graph 2.15
Growth of Export and Import of Goods and Services



Graph 2.16
Contribution to Growth

on the part of several countries that tended to raise non-tariff barriers to protect their domestic industries; (iii) trade diversion in line with the formation of trading blocks; and (iv) weak primary commodity prices. These problems have been worsened by excess global supply conditions.

In the meantime, imports recorded a sharp contraction. Import of goods and services in the reporting year fell by 8.3%, much worse than the pervious year's increase of 8.1% (Graph 2.15). This fall was closely associated with weak investment and the low growth of export-oriented manufacturing, which has a high import content, mainly raw materials and capital goods. In the reporting year, the growth of imports of raw materials contracted by 2.9%, while imports of capital goods fell by 6.7%.[4]

AGGREGATE SUPPLY

Economic growth from the production side increased in 2002 with expansion in all the main sectors (Table 2.6). Nonetheless, among the 9 economic sectors, only 4 recorded higher growth, namely agriculture, mining, transportation, and financial services. All other sectors slowed, including manufacturing, which has the largest share in GDP. By contribution to growth, the main contributors in 2002 were manufacturing, trade, hotels and restaurants, and transportation (1.1%, 0.6%, and 0.6%, respectively; Graph 2.16). The mining sector, which did not expand last year, grew by 2.3% in 2002.

The manufacturing sector grew by 4.0% in 2002 and made a contribution of 1.1% to GDP. As just noted, this growth is slightly lower than in the previous year (4.1%). There have been several problems inhibiting growth in manufacturing, such as: high business risks; rising production costs (due in part to the adjustment in fuel and electricity prices); and new levies growing out of regional autonomy.

Lower growth in this sector was also inherent in unsettled problems that limit bank intermediation, despite lower SBI rates. Although the total amount of new credit did increase during 2002, that increase was not sufficient to generate higher growth. Indeed, outstanding bank credits channeled to manufacturing declined as compared to 2001. In addition, basic

4 Source: Indonesia's Balance of Payments.

(Percent)

Tabel 2.6
Economic Growth by Sector

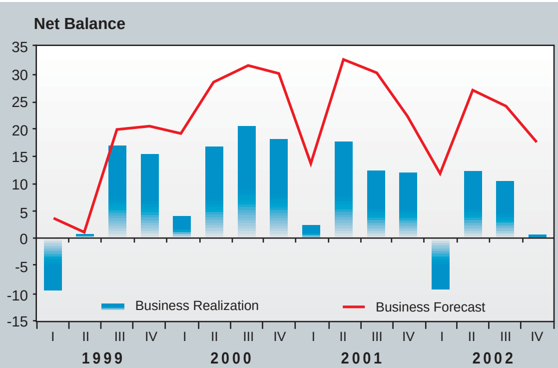
Sector[1)]	1999		2000		2001*		2002**	
	Growth	Contribution	Growth	Contribution	Growth	Contribution	Growth	Contribution
Agriculture	22.0	0.4	1.9	0.3	1.0	0.2	1.7	0.3
Mining	-1.6	-0.2	5.5	0.5	0.0	0.0	2.3	0.2
Manufacturing	3.9	1.0	6.0	1.6	4.1	1.1	4.0	1.1
Electricity	8.3	0.1	7.6	0.1	7.7	0.1	6.2	0.1
Construction	-1.9	-0.1	5.6	0.3	4.2	0.2	4.1	0.2
Trade	-0.1	0.0	5.7	0.9	5.3	0.9	3.6	0.6
Transportation	-0.8	-0.1	8.6	0.6	7.3	0.5	7.8	0.6
Financial	-7.2	-0.5	4.6	0.3	3.4	0.2	5.6	0.4
Services	1.9	0.2	2.3	0.2	2.0	0.2	2.0	0.2
GDP	**0.8**	**0.8**	**4.9**	**4.9**	**3.4**	**3.4**	**3.7**	**3.7**

1) Name of sector are simplified
Source : BPS-Statistic Indonesia

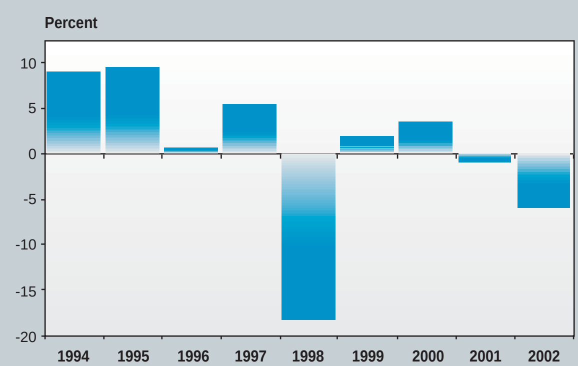
problems in the Indonesian economy (such as legal uncertainty) have hindered economic recovery. The competition from other countries (such as Vietnam, China and India) constituted another challenge faced by Indonesian businessmen. The impact of this problem can be seen in the closing and relocation of several foreign companies.

Lower growth of manufacturing was also reflected in the Business Survey conducted by Bank Indonesia and the Business Tendency Survey done by BPS (Graph 2.17). These two surveys showed weaker conditions, indicating declining optimism among businessmen towards their companies and business conditions. The weaker business prospects were mainly due to a decline in new orders from both domestic and foreign clients. The same picture was painted by the survey of big and medium industries whose production indexes contracted in 2002 (Graph 2.18).

Despite these various problems, economic activity on the production side still expanded, although



Graph 2.17
Business Survey



Graph 2.18
Production Index

the growth could not meet all the increase in domestic demand. The rising economic activities were reflected in higher utilization rates in manufacturing, particularly for electronic goods and chemical, agricultural and forestry products, which have a total share of more than 80% in manufacturing. In some cases, utilization rates have been above their pre-crisis level (Table 2.7). Other indicators, such as the production of motorcycles, have been on a rising trend since 1998 (Graph 2.19).

The trade, hotels and restaurants sector increased by 3.6%, lower than the previous year's 5.3%. With this lower growth, the contribution of this sector to GDP growth reached only 0.6%. Growth in this sector was mainly accounted for by wholesale and retail trade in line with rising consumption.

Expansion of trade was reflected in the opening of many retail shops during the reporting year. Also, the Retail Sales Survey up to December 2002 showed an increase but at a slower pace than the previous year. The lower growth was aggravated by the Bali tragedy, which adversely affected the hotels and restaurants sub-sectors.

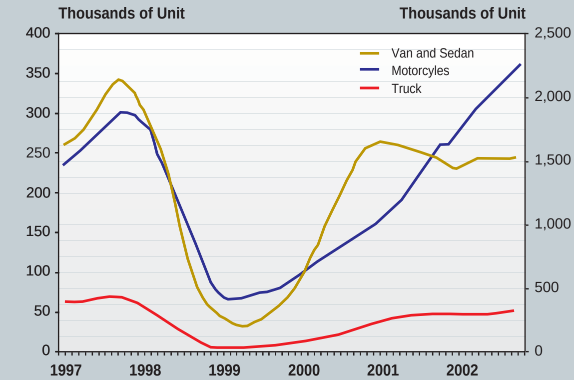
Transportation and communications grew by 7.8% in 2002, a bit higher than the previous year (7.3%). The impact of the Bali tragedy, which took place in the last quarter of 2002, was not so significant for this sector,

(Percent)

Table 2.7
Utilization Rate of Chemical, Agriculture, and Forest Product Industry

Industry	1997	1998	1999	2000	2001	2002*
Basic Chemical	72.1	65.4	66.0	75.9	80.8	84.8
Processed Chemical	78.1	54.9	64.3	70.4	72.2	75.8
Chemical Agriculture Product	69.0	67.8	68.0	69.6	71.8	75.4
Agriculture	47.5	44.2	46.4	53.4	53.4	56.1
Forest Product	68.4	58.5	60.1	67.4	57.8	60.7
Average	**67.0**	**58.2**	**61.0**	**67.3**	**67.2**	**70.6**

Source : Ministry of Industry and Trade



Graph 2.19
Vehicle Production

which accelerated through the first three quarters of 2002 as compared to the same period in the previous year. Growth was mainly driven by the transportation sub-sector, particularly inland and air transportation. As regards air transportation, additional airline companies and government policy to limit prices has induced tighter competition pushing down the price of airline tickets. The Bali tragedy caused air transportation to slow during the final quarter of the year.

For the communication sub-sector, its growth in 2002 partly stemmed from deregulation in the telecommunication sector. This deregulation increased competition among companies in this sector and promoted investments by the main operators. Also, new programs from cellular telephone operators gave a boost to growth.

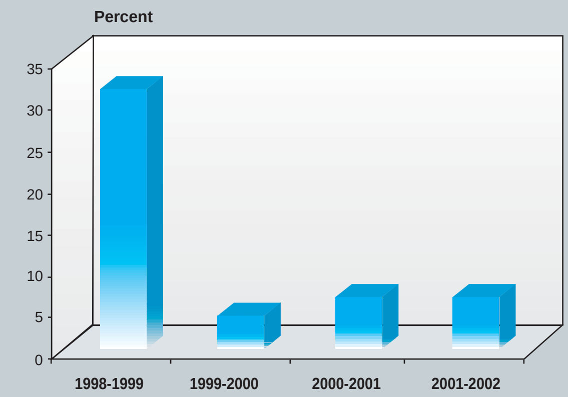
Agriculture expanded by 1.7%, up from 1.0% in the previous year. This was mainly due to the food crop sub-sector through increased productivity and expansion of agricultural land. In addition, the natural phenomenon of El Nino, which had been expected to return, did not take place. In anticipation of possible reductions in production resulting from drought, the Agricultural Ministry encouraged expansion of arable land and improved the supply of seeds to farmers. A good harvest was also due to an adequate supply of domestic fertilizer as there were no disruptions in the supply of gas to the fertilizer industry.

Another important development in the agriculture sector in 2002 was a shift of the harvest season. Floods in late 2001 and early 2002 caused delays in the rice planting season, which pushed the harvest into the second quarter. Hence, rice production rose significantly in the second quarter and was able to compensate for declining activity in other sub-sectors which were weak in the first half of 2002. The plantation sub-sector also made a significant contribution to the growth of agriculture. By contrast, forestry contracted due to government policies that constrained activity consistent with environmental sustainability.

Other sectors generally improved. For example, the financial sector raised more funds and extended more credits, which is evidence of improved intermediation. Construction also expanded, mainly driven by improvements to infrastructure undertaken by the government; the implementation of several large toll projects in various areas of the country; and the development of commercial and residential property.

Interaction of Demand and Supply

Developments on the supply side improved, although not as much as expected. Weaker investment and falling imports of raw materials and capital goods limited additions to productive capacity. But the rise in supply was not adequate to meet domestic demand, with the difference covered by a larger supply of



Graph 2.20
Incremental Capital-Output Ratio (ICOR)

consumer goods imports, which held down demand side pressures.

Unfavorable economic developments were also reflected in the incremental capital output ratio (ICOR) which is a measure of economic efficiency. In the reporting year, the ICOR was relatively constant (Graph 2.20), meaning that rising GDP had to be matched by higher investment, with the same ratio as in the previous year.

EMPLOYMENT

Labor market developments in 2002 were on a deteriorating trend, as reflected in additions to the work force that exceeded additional working opportunities, due to relatively low economic growth. At the same time, efforts to raise labor's welfare have not been successful because of continuing inflation, which kept the provincial minimum wage (Upah Minimum Propinsi/UMP) well below the minimum level of basic needs (Kebutuhan Hidup Minimum/KHM). Domestic labor problems and issues of illegal Indonesians working abroad added to employment hardships in 2002.

(Millions of People)

Table 2.8
Labor Force and Unemployment

	1997	1998	1999	2000	2001	2002*
Population	**195.8**	**198.5**	**200.3**	**205.8**	**208.9**	**212.0**
Economically Active Population	**135.1**	**138.6**	**141.1**	**141.2**	**144.0**	**148.4**
Labor Force	**89.6**	**92.7**	**94.8**	**95.7**	**98.8**	**100.5**
Labor Force Participation Rate (%)	**66.3**	**66.9**	**67.2**	**67.8**	**68.6**	**67.8**
Employed	**85.4**	**87.7**	**88.8**	**89.8**	**90.8**	**91.6**
Formal	31.7	30.3	31.9	31.5	29.4	29.2
Informal	53.7	57.3	56.9	58.3	61.4	62.4
Employed >= 35 Hours per Week	57.4	55.7	57.4	59.7	60.4	62.8
Employed < 35 Hours per Week (semi unemployed)	28.0	31.9	31.4	30.1	30.4	28.9
Open Unemployment	**4.2**	**5.1**	**6.0**	**5.8**	**8.0**	**9.1**
Open Unemployment Rate (%)	**4.7**	**5.5**	**6.4**	**6.1**	**8.1**	**9.1**
Open Unemployment and Semi Unemployed	**32.2**	**37.0**	**37.4**	**35.9**	**38.4**	**38.0**
Open Unemployment and Semi Unemployed Rate (%)	**36.0**	**39.9**	**39.4**	**37.5**	**38.9**	**37.8**
Non-labor Force	**45.5**	**45.8**	**46.3**	**45.5**	**45.2**	**48.3**
Not Economically Active	**60.7**	**59.9**	**59.2**	**64.6**	**64.9**	**63.6**

Source : BPS-Statistic Indonesia

Working Age Population and Labor Force

At the end of 2002, the working age population reached 148.4 million people,[5] up from 144 million a year previously. Of that number, 67.7% or 100.5 million belonged to the work force. Also in 2002, total employment (that is, the number of citizens who are working) reached 91.6 million, which is up 1.7% compared to 2001 (Table 2.8). On this basis, the employment ratio (that is, total employment as a percentage of total labor force) slipped to 91.2% from 91.9% in 2001. Applying higher standards of working time (that is, working a minimum of 35 hours per week), only 62.8 million people were fully employed. On this measure, the employment ratio was only 62.5%.

By type of work, there was lower employment in the agriculture and services sectors. Nonetheless, agriculture is still the most important sector, absorbing 42.5% of the labor force, followed by trade, hotels and restaurants (19.6%), manufacturing (13.7%) and services (11.9%). By profession (that is, type of job) agriculture also dominated (42.1%), followed by production workers (25.4%) and sales workers (18.4%). The number of executives and professionals remained very small, namely 0.4% and 3.5% of the total labor force, respectively (Table 2.9).

By employment status, the number of citizens working in the formal sector declined by 0.5%. The decline was due to a smaller number of persons working as staff employees/workers. On the other hand, there were a larger number who are fixed employees/

(Millions of People)

Table 2.9
Number of Employment by Economic Sector

	1997	1998	1999	2000	2001	2002*
Agriculture	34.8	39.4	38.4	40.7	39.7	39.0
Trade, Hotel and Restaurant	17.0	16.8	17.5	18.5	17.5	17.7
Manufacturing	11.0	9.9	11.5	11.6	12.1	12.6
Services	12.6	12.4	12.2	9.6	11.0	10.9
Other	10.1	9.1	9.2	9.5	10.5	11.5
Total	**85.4**	**87.7**	**88.8**	**89.8**	**90.8**	**91.6**

Source : BPS-Statistic Indonesia

5 Source: BPS

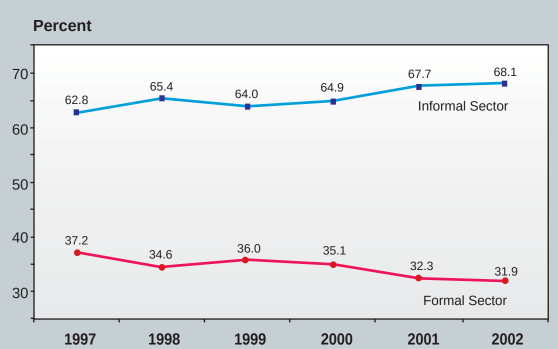
(Millions of People)

Table 2.10
Employment by Type of Jobs

	1997	1998	1999	2000	2001	2002*
Formal Sector	**31.7**	**30.3**	**31.9**	**31.5**	**29.4**	**29.2**
Employee	30.3	28.8	29.4	29.5	26.6	26.2
Employer	1.5	1.5	2.6	2.0	2.8	3.0
Informal Sector	**53.7**	**57.3**	**56.9**	**58.3**	**61.4**	**62.4**
Self-employed	19.9	20.5	21.7	19.5	17.5	19.1
Self-employed assisted by family member/temporary employee	18.0	19.7	18.9	20.7	20.3	18.0
Free worker in agriculture	0.0	0.0	0.0	0.0	3.6	4.2
Free worker in non-agriculture	0.0	0.0	0.0	0.0	2.4	3.3
Unpaid worker	15.8	17.1	16.3	18.1	17.6	17.9
Total Employment	**85.4**	**87.7**	**88.8**	**89.8**	**90.8**	**91.6**

Source : BPS-Statistic Indonesia

workers. This indicates that the number of formal business units actually increased in 2002, but overall formal sector employment was less than in 2001. The number of those working in the informal sector increased by 1.6%, due to rising numbers of free workers and those who are self-employed, without help from family members or fixed employees/ workers (Table 2.10). This development indicates a shift of work from the formal to the informal sector, such that the share of those working in the formal sector has tended to decline since 1997 (Graph 2.21).

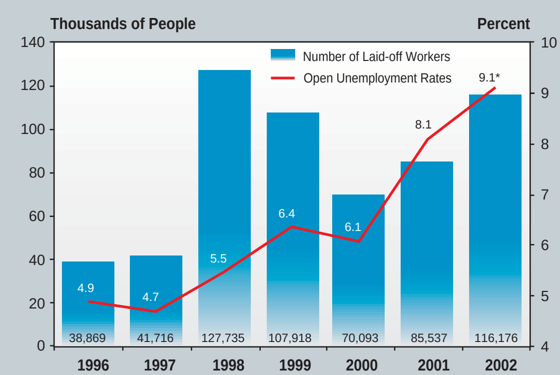


Source : BPS-Statistic Indonesia

Graph 2.21
Worker Proportion of Formal-Informal Sector

Unemployment Rate

In 2002, the number unemployed reached 38.0 million, consisting of 9.1 million who are openly unemployed and another 28.9 million who are under-employed. The rising number of unemployed was due to low economic growth, which only created enough jobs to absorb 0.8 million people, whereas total additions to the labor force reached 1.7 million. Consequently, the open unemployment rate rose from 8.1% in 2001 to 9.1% in 2002 (Graph 2.22). By educational levels, open unemployment increased



Source : BPS-Statistic Indonesia

Graph 2.22
Open Unemployment and Number of Laid-off Workers

Table 2.11
Open Unemployment by Educational Level

	1997	1998	1999	2000	2001	2002*
< Primary	216,495	257,330	278,500	221,242	851,426	1,110,200
Primary	760,172	911,782	1,151,252	1,216,976	1,893,565	2,393,300
Junior High	736,375	984,104	1,159,478	1,367,892	1,786,317	1,874,600
Senior High	2,106,182	2,479,739	2,886,216	2,546,355	2,933,490	3,157,700
> Senior High	378,082	429,528	554,873	460,766	540,233	564,200
Total	**4,197,306**	**5,062,483**	**6,030,319**	**5,813,231**	**8,005,031**	**9,100,000**

Source : BPS-Statistic Indonesia

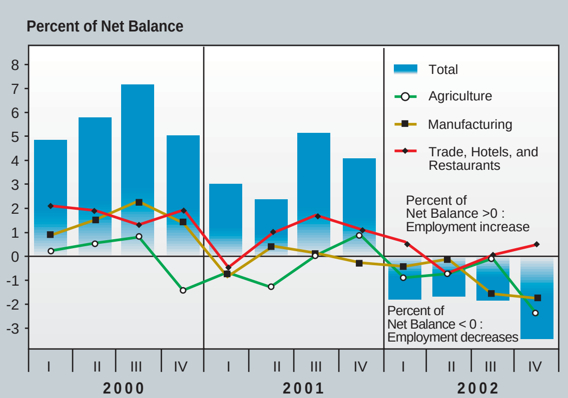
among those educated up to primary school, whereas it decreased among those with upper secondary education (Table 2.11). However, open unemployment was dominated by persons with high school education (34.7%).

In addition to new entrants into the labor force, the number of unemployed also increased due to lay offs, mainly as a result of rationalization or termination of production activities in manufacturing. During 2002, there were 3,774 cases of lay offs with 116,176 people losing their jobs. This number was only a little below the number of lay offs at the peak of the crisis in 1998, 127,735 job losses (Graph 2.22). This situation was magnified by the impact of the Bali tragedy, which slowed economic activity in several sectors related to tourism (for example, trade, hotels and restaurants, transportation and other services).

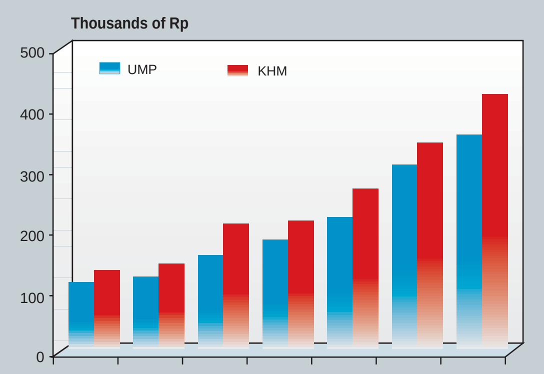
Rising unemployment and layoffs were in line with Employment Indicators of the Business Survey. On average, all sectors recorded a negative weighted average net balance (Graph 2.23). This indicates that the number of companies reducing their labor force exceeded the number of companies increasing their work force. By sector, the biggest reduction in employment was in agriculture.

Minimum Wages

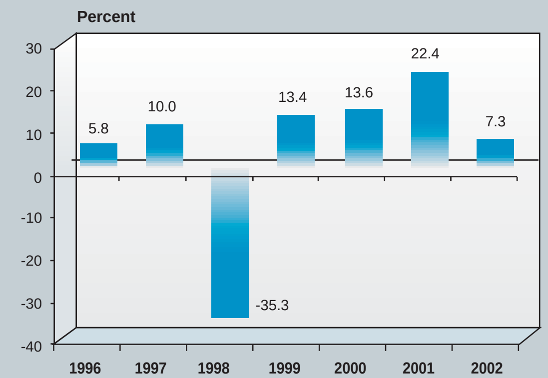
On average, the provincial minimum wage (UMP) in 2002 reached Rp362,743/month, which is up 18.1% from the previous year (Graph 2.24). However, this increase is still lower than the rise in basic needs (KHM) which reached around Rp422,347/month in 2002, up 23.0% over 2001. Relatively high inflation limited gains in workers' purchasing power; the increase in real minimum wages declined from 22.4% in 2001 to 7.3% in 2002 (Graph 2.25). By sector, the highest minimum wage in several provinces (such as Central Kalimantan, Irian Jaya, Maluku, and North



Graph 2.23
Employment



Graph 2.24
UMP and KHM



Source : Ministry of Manpower and Transmigration (processed)

Graph 2.25
Real UMP Growth

Maluku) was recorded in the mining sector. In other provinces, wages in manufacturing, trade, and financial services were the highest.

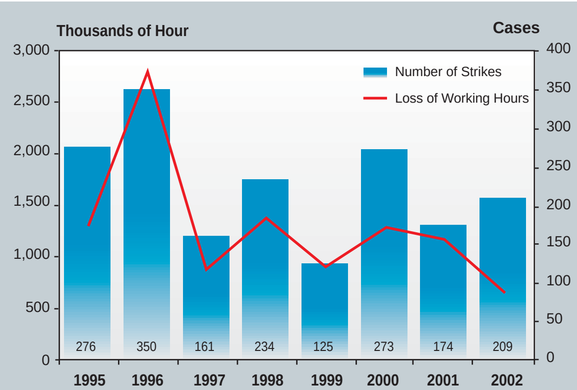
Labor Force Problems

Indonesia's labor force problems have been colored by a rising number of strikes. Up to November 2002, there were 209 strikes, involving 92,325 workers and causing a loss of 659,102 working hours (Graph 2.26). Although the number of strikes increased, the impact on productivity was less because the number of lost working hours was down from 2001. In addition to disputes over wages, several other factors triggered the strikes, including dissatisfaction with working conditions; unfair treatment; demands to improve facilities and working allowances; gender issues; social security issues; and rejection of companies' new working methods.

The main problems of the Indonesian Labor Force (Tenaga Kerja Indonesia/TKI) abroad in 2002 concerned the implementation of new, stricter policies by the Malaysian government towards illegal workers. This triggered a major repatriation of illegal TKI from Malaysia. In addition to increasing the number of job seekers in the Indonesian market, the repatriation of illegal TKI also affected the village economy, because relatively large amounts of money had been transferred home by the TKI while they were working abroad.

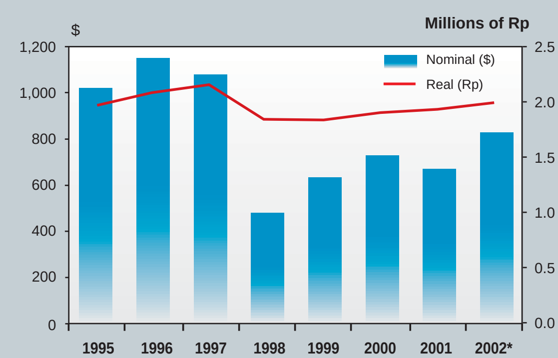
Income Per Capita

In 2002, the total population of Indonesia was estimated to reach some 212 million. Nominal income per capita in 2002 reached Rp7.6 million or equivalent to $811, which is up substantially from $677 in 2001. In



Source : BPS-Statistic Indonesia

Graph 2.26
Number of Strike Cases and Loss of Working Hours



Source : BPS-Statistic Indonesia

Graph 2.27
Per Capita Income

real terms, income per capita in 2002 reached around Rp2 million,[6] or equivalent to $215. Although this is an increase of 2.1% over 2001, real income per capita in 2002 remained much lower than in 1997 (Rp2.2 million), that is before the crisis hit Indonesia (Graph 2.27). It should be noted that the increase in per capita nominal income in 2002 was largely due to the appreciation of the rupiah exchange rate in that year.

6 GDP based on 1993 constant prices divided by population.

CHAPTER 3

Annual Report

The Exchange Rate

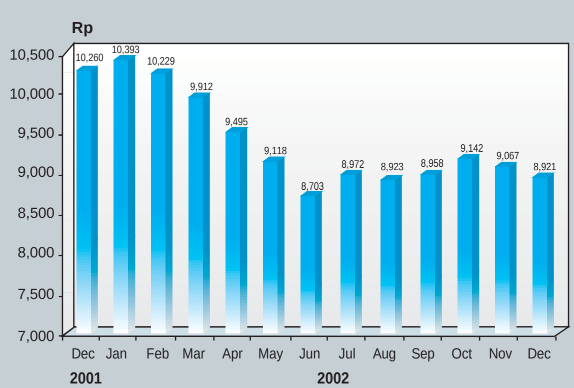
CHAPTER

3 THEEXCHANGERATE

The rupiah exchange rate appreciated significantly with lower volatility due to stronger fundamentals and improved sentiment, supported by intervention policy.

After depreciating during 2001, the rupiah exchange rate appreciated significantly during the reporting year. Overall, it strengthened significantly, by 10.1% from an average of Rp10,255 per dollar in 2001 to Rp9,316 in 2002. On a point-to-point basis, it appreciated even more, by 16.2% from Rp10,400 at the end of 2001 to Rp8,950 by the end of 2002. As a result, the rupiah appreciated more than any other currencies in Asia during 2002.

Exchange rate developments during 2002 could be divided into two phases (Graph 3.1). In the first phase, which lasted from January until June 2002, the rupiah tended to strengthen markedly, reaching a peak of Rp8,425 per dollar with relatively little volatility. During this period, the strengthening of the rupiah mainly stemmed from fundamentals, originating in the balance of payments and triggered by improved sentiment and Bank Indonesia's efforts in stabilizing the rate.



Graph 3.1
Rupiah Exchange Rate (Monthly Average)

In the second phase, lasting from July until December 2002, the rupiah exchange rate fluctuated more. Movements during this phase were caused by negative sentiments and higher demand for foreign exchange in the domestic market, mainly due to the Bali tragedy. The rupiah dropped to its lowest value, Rp9,425 per dollar, in October 2002. However, it rebounded quickly due, in part, to Bank Indonesia's efforts to regain market confidence. Renewed market confidence from stronger sentiment and fundamentals, then kept the rupiah below Rp9,000 per dollar by the end of the review period.

The exchange rate's movements during 2002 were attributable to several factors, including fundamentals, sentiments and Bank Indonesia policy. From the side of fundamentals, the general strengthening during 2002 was mainly due to the balance of payment surplus accounted for by a narrowing deficit on capital account and a widening surplus on current account.

Concerning sentiments, positive factors were mainly associated with progress in economic restructuring, such as rescheduling foreign debts, disbursements of IMF loans, implementation of the banking divestment program and privatization of state-owned enterprises. This positive development is confirmed by improvement in risk indicators such as credit ratings, risk premium and swap premium.[1]

On the policy side, Bank Indonesia undertook various efforts, mainly in minimizing fluctuations of the rupiah. These included foreign exchange intervention and other less conventional policies, such as moral suasion vis-a-vis market players and monitoring foreign exchange transactions by banks and major non-bank market players.

FACTORS AFFECTING THE EXCHANGE RATE

Fundamental factors

Fundamentally, the tendency for exchange rate appreciation during the reporting period was inherent in the improved performance of the external sector as reflected in the surplus on Indonesia's Balance of Payments (BOP). During the reporting year, the BOP recorded a surplus of $3.6 billion, compared with a deficit of $1.4 billion last year. This surplus originated in a markedly narrowing deficit on capital account and a widening surplus on current account (see Chapter 6, the Balance of Payments).

The deficit on capital account declined sharply from $9.0 billion in 2001 to $3.6 billion in the reporting year. The narrowing deficit was mainly attributed by disbursements of IMF loan, private and official foreign debt rescheduling, declines in private debt servicing, successful divestments of banks and privatizations of state-owned enterprises, and sizable foreign currency denominated private bond issuance in foreign markets.

1 Risk premium is the spread between yield on 10 year Indonesia Yankee bond and 10 year US Treasury Note, both due at 2006.

The surplus on the current account rose from $6.9 billion to $7.3 billion during the same period. The wider surplus was due to a sharper drop in imports than exports. Meanwhile, the deficit on services account virtually unchanged in both oil/gas and non-oil/gas sector.

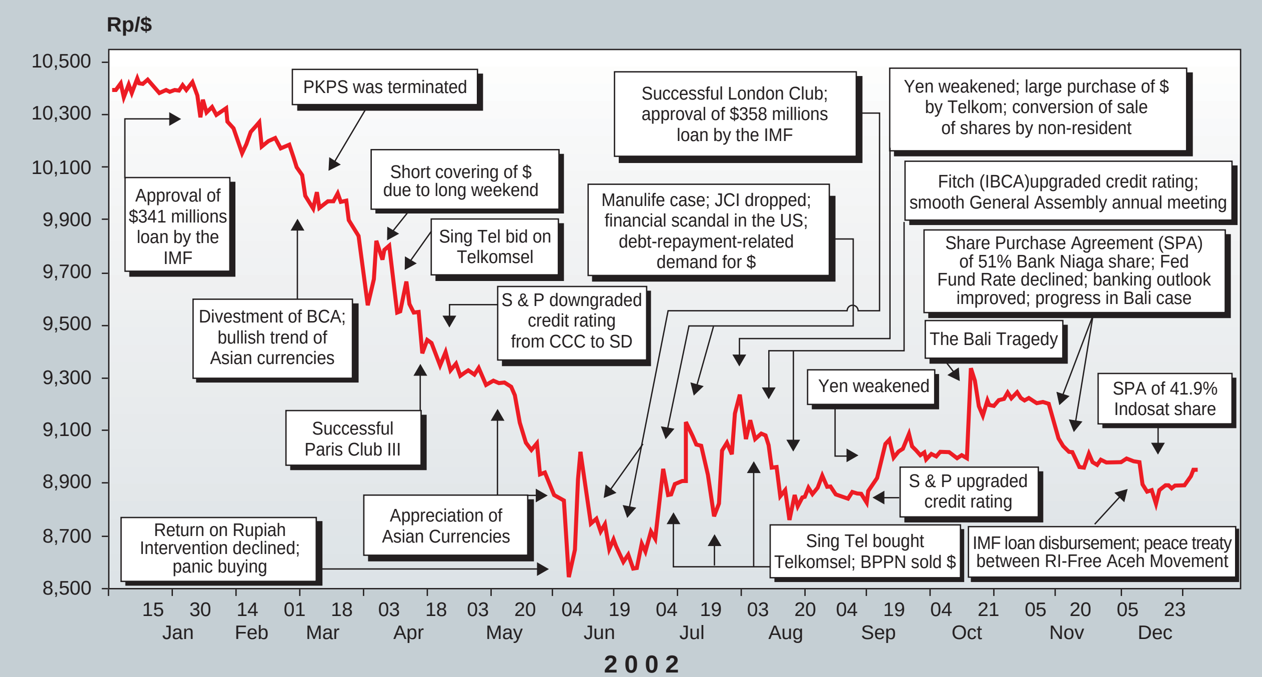
Sentiment Factors

The strengthening tendency of the rupiah exchange rate during the first phase was also triggered by a number of sentiment-related factors (Graph 3.2). Those factors may be classified as follows:

i. **General appreciation of Asian currencies.** The continuingly weak performance of the US economy caused weakness in the dollar vis-à-vis other major currencies, such as the yen and the euro. This boosted most regional currencies, including the rupiah.

ii. **The government's success in negotiations with donor countries.** Government negotiations with donor countries, including within Paris Club (PC) III, resulted in an approved repayment rescheduling on official debt in the amount of $5.4 billion, of which $2.4 billion due in 2002 and $3.0 billion in 2003. Following the PC III forum, commercial creditors of the London Club forum eventually approved the official commercial debts rescheduling. Also, the IMF disbursed loans to Indonesia around $1.1 billion during the first six months of 2002.

iii. **Progress in divestment and privatization of banks and state-owned enterprises.** IBRA succeeded in completing the divestment of BCA, while the privatization process for a number of state-owned



Graph 3.2
Rupiah Exchange Rate Development and Sentiment Factors

enterprises (such as Bank Mandiri, PT Telkom, and PT Indofarma) has been gradually implemented. In addition, the government policy to extend the period for The Settlement of Shareholders' Obligations (Penyelesaian Kewajiban Pemegang Saham/PKPS) for not more than three months, received a positive response from the market.

iv. **Significant foreign investor interest in government assets.** The divestment and privatization of banks and state-owned enterprises has attracted foreign investors (for example, Farallon Capital, which won the purchase tender of BCA's equity).

By contrast, negative sentiment during the first phase, mentioned above, partly originated in the downgrading of Indonesia credit rating by Standard & Poor's (S&P) from CCC to "Selective Default" (SD) in April 2002 and profit-taking (to purchase dollars) when the rupiah appreciated. However, positive sentiment generally dominated, causing the rupiah to appreciate from January through June 2002.

During the second phase, the rupiah tended to fluctuate owing to a number of negative sentiment-related factors, as follows:

i. **Depreciation of regional currencies.** Depreciation of the rupiah during the second phase was largely a by-product of general Asian currency depreciation vis-a-vis the dollar. Deteriorating global economic conditions, the threat of US attack on Iraq, and international terrorism have elevated security risks and business uncertainty while the dollar is still considered to be a "safe haven currency".

ii. **Foreign investor confidence in the capital market weakened.** Weakening investor confidence was initiated by a drop in the Dow Jones Industrial Index, partly due to financial scandals involving large American companies. The negative sentiment spread to other bourses around the world, including sales by foreign investors in the Jakarta Stock Exchange (JSE). This put some pressures on the rupiah exchange rate.

iii. **The Bali bombing had shattered international investors' confidence and encouraged them to take long dollar positions.** This tragedy delayed the CGI meeting to be held in Yogyakarta in October 2002. It also caused foreign exchange receipts from tourism to plunge. Deepened pessimism, as reflected in the evaluation of Political and Economic Risk Consultancy Ltd (PERC) concerning worsening security risks in Indonesia.

Although the depreciation of rupiah during the second phase was significant, there were a number of positive elements that limited the extent of the depreciation, and alternately brought about a turn-around. Those aspects were:

i. **Economic Aspects.** Improvements in several economic indicators (such as the wider surplus in the balance of payments, lower inflation and interest rates, base money below its indicative target, and a narrower fiscal deficit than budgeted) raised donors' confidence as reflected in the IMF loan disbursement of $365 million in December 2002. The source of the improved fiscal performance was another contributing factor, namely the government's successful divestment of Bank Niaga, privatization of PT Indosat, and reprofiling of government recap bonds (see Box : Government Bond Reprofilling in Chapter 7).

ii. **Political, Legal and Security Aspects.** Concerning the political dimension, the rupiah was supported by conducive political conditions after the Annual Meeting of the General Assembly (MPR) in 2002, which proceeded smoothly, virtually without security incidents. Regarding legal aspects, government efforts to handle the Bali bombing were supported by various countries while there was a rapid progress that helped investors' confidence to recover. On security, optimism returned with the signing of a peace treaty between the Indonesian Government and GAM (Free Aceh Movement) in December 2002.

iii. **Country Risk.** Following the success of the Paris and London Clubs, debt-rating agencies (such as Fitch IBCA and S&P) upgraded Indonesia's credit rating. Even after the Bali tragedy, S&P raised its outlook for bank debt in 2003.

Risk Indicators

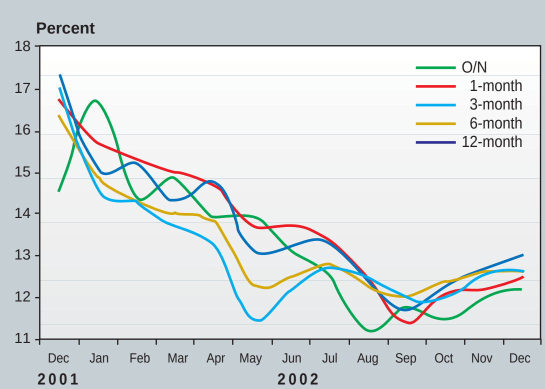
Indonesian country risk generally lessened as reflected in the improved sovereign credit ratings given by two international rating agencies, namely Fitch IBCA and S&P (Table 3.1). These improvements were based on the approved official debt payment rescheduling under the PC III forum and London Club. Fitch upgraded Indonesia's credit rating for foreign and local currency long-term debt, to B from B^- effective August 1, 2002. S&P followed by raising Indonesia's rating from "Selective Default (SD)" to CCC^+, which was effective September 5, 2002. Furthermore, shortly after the Bali tragedy, S&P raised the outlook for bank debt in 2003 from "Negative" to "Stable". All of these showed optimism regarding Indonesia's economic prospects.

Table 3.1
Sovereign (Foreign Currency Long Term) Debt Ratings

Country	S & P		MOODY'S		FITCH IBCA	
	Rating	Effective	Rating	Effective	Rating	Effective
Malaysia	BBB+	20-Aug-02	Baa2 *+	24-Jun-02	BBB+	7-Aug-02
	BBB	10-Nov-99	Baa2	17-Oct-00	BBB	7-Dec-99
	BBB-	15-Sep-98	Baa3 *+	12-Jul-00	BBB- *+	9-Sep-99
Thailand	BBB-	8-Jan-98	Baa3	21-Jun-00	BBB-	24-Jun-99
	BBB	24-Oct-97	Ba1 *+	3-Apr-00	BB+ *+	26-Apr-99
	A-	3-Sep-97	Ba1 *+	21-Dec-97	BB+	14-May-98
Philippines	BB+	21-Feb-97	Ba1	18-May-97	BB+	15-Mar-01
	BB	30-May-95	Ba2 *+	23-Jan-97	BB+ *-	17-Jan-01
	BB-	30-Jun-93	Ba2	12-May-95	BB+	8-Jul-99
Indonesia	CCC+	5-Sep-02	B3	20-Mar-98	B	1-Aug-02
	SD	23-Apr-02	B2	9-Jan-98	B-	16-Mar-98
	CCC	2-Nov-01	Ba1	21-Dec-97	B+ *-	21-Jan-98

Investment Grade **Non-Investment/Speculative Grade**

In the meantime, the Hong Kong rating agency, Political and Economic Risk Consultancy Ltd (PERC), concluded that Indonesia's country risk had worsened after the Bali tragedy. This was based on rising security risks that damaged tourism, weakened the investment climate, and disrupted international trade. The rating downgrade was also based on the fiscal burden that was predicted to become heavier as a result of the delay of the CGI meeting of October 2002. However, this agency's downgrading did not erode the positive sentiment towards Indonesia's economic prospects as reflected in improved risk indicators.

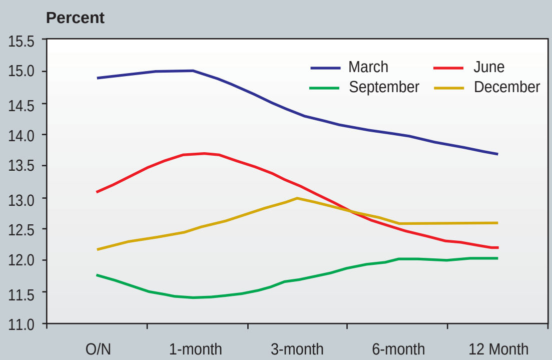


Graph 3.3
Swap Premium

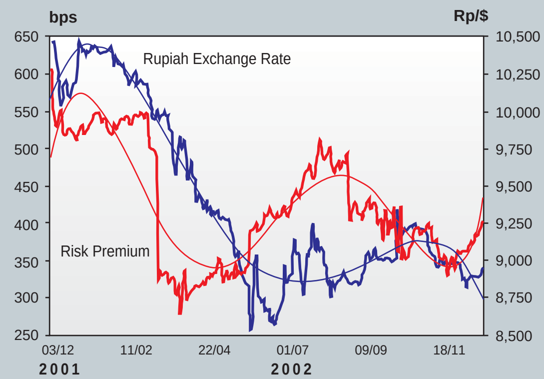
Improved country risk was confirmed by several market-based risk indicators. A short-term risk indicator, the swap premium, has been on a downward trend for all tenors since the end of 2001 (Graphs 3.3 and 3.4). The 1-month premium swap declined from 16.80% at the end of 2001 to 12.53% at the end of 2002; the 3-month premium swap declined from 17.30% to 13.00%. With 1-month SIBOR also declining (from 1.88% to 1.38%), the implied[2] 1-month swap premium dropped sharply from 18.68% to 13.91% during 2002. Despite these declines, the implied swap premium was still higher than the 1-month SBI rate, which was down to 12.93% at the end of the reporting period.

The decline of both domestic (JIBOR) and foreign (SIBOR)[3] in swap premium and interest rates resulted in

2 The implied swap premium is the rate of swap premium plus the interest rate of foreign currency deposits/savings.
3 JIBOR is treated as benchmark for domestic inter-bank rate: SIBOR is a benchmark for foreign/offshore inter-bank rate (Singapore)



Graph 3.4
Swap Yield Curve

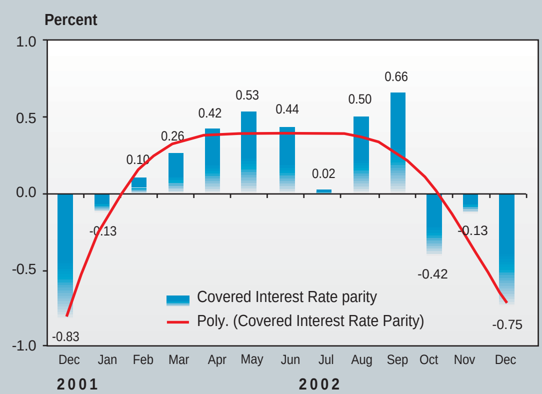


Graph 3.6
Rupiah Exchange Rate and Premium

improvement of covered interest rate parity.[4] After experiencing a negative covered interest rate for the whole year of 2001, it started to record a positive number since February for 8 consecutive months (Graph 3.5). The Bali tragedy triggered a jump in the swap premium, causing the covered interest rate to turn negative in October 2002. However, it ended the year at -0.75%, slightly improved than a year previously (–0.83%).

A longer-term risk indicator such as the risk premium, improved appreciably during 2002, from 534 bps to 402 bps (Graph 3.6). This is attributable to a higher decline on the yield of US Treasury Notes during the reporting year. The narrower spread between the two yields mainly indicates an improvement of market expectations toward rupiah value. Despite lowering risk premium, this indicator suggests that risks in Indonesia remain relatively high, since it is still considerably above that of other Asian countries (e.g., China, South Korea and Malaysia) that were ranged between of 150-250 bps.

4 Covered interest rate parity = domestic interest rate (1-month JIBOR) – foreign interest rate (1-month SIBOR) – swap premium (1-month).



Graph 3.5
Covered Interest Rate Parity

Policy Factors

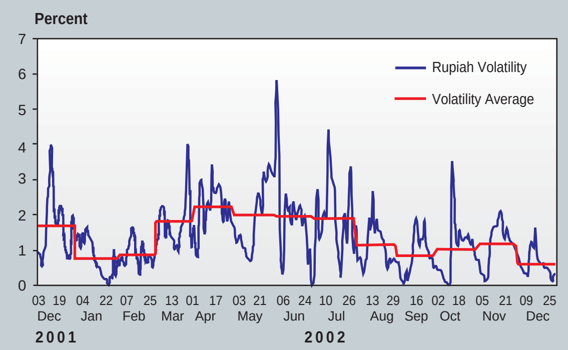
To stabilize the rupiah during the reporting period, Bank Indonesia undertook various policies through optimizing its available instruments. These steps included consistent absorption of excess rupiah liquidity through Open Market Operations (OMO), supervision of the implementation of regulations limiting rupiah transactions by non-residents, supervision of foreign exchange transactions, moral suasion, and foreign exchange sterilization/ intervention.

To limit foreign exchange speculation, Bank Indonesia continued to monitor the compliance of banks in their foreign exchange transactions, according to PBI No.3/3/2001 dated January 12, 2001 on the Limitation on Rupiah Transactions and Foreign Currency Credit Expansion by Banks. In this regard, forward sale and swap sale transactions to non-residents in certain amounts continued to be prohibited, unless for real economic transactions (underlying transactions). This monitoring strengthened banks' compliance, thereby helping to lessen volatility of the rupiah.

To monitor market developments, Bank Indonesia carefully scrutinized foreign exchange transactions through the Money Market Information Center (Pusat Informasi Pasar Uang/PIPU). This monitoring is aimed at ensuring that market transactions are on a normal track according to common practice prevailing in the foreign exchange market. This monitoring is part of the early warning system, in identifying transactions at an early stage that could potentially destabilize the rupiah market. In addition, Bank Indonesia routinely conducts surveys to learn about market agents' perceptions on the direction of exchange rate development. The result from this survey is one consideration in implementing exchange rate policy.

Based on its monitoring of market conditions, Bank Indonesia undertook moral suasion by extending information to market agents in order to ease off market pressures. During the reporting period, this was done on several occasions, for example, moral suasion when there was panic buying of dollars by market players who over-reacted to the Bali tragedy. This policy strengthened market confidence and prevented further rupiah depreciation.

To complement these various policies, Bank Indonesia also undertook foreign exchange sterilization/



Graph 3.7
Exchange Rate Volatility

intervention by selling dollars (to add supply of dollars) in the market. These operations served two purposes. In addition to its role in absorbing excess rupiah liquidity, the policy also aimed at lessening volatility in the rupiah exchange rate and to ease off market pressures, simultaneously. In its implementation, this policy was undertaken consistently, taking into account market psychology and the adequacy of foreign exchange reserves. This policy was successful in reducing rupiah fluctuations throughout the reporting year as shown in a declining average daily volatility[5] of the rupiah exchange rate to 1.4% from 2.8% in the previous period (Graph 3.7). Looking at the level of the exchange rate, the foreign exchange sterilization/intervention policy was also quite effective in maintaining the appreciating trend of the rupiah during 2002, and keeping the exchange rate below Rp9,000 per US dollar until the end of the year.

SUPPLY AND DEMAND OF FOREIGN CURRENCY

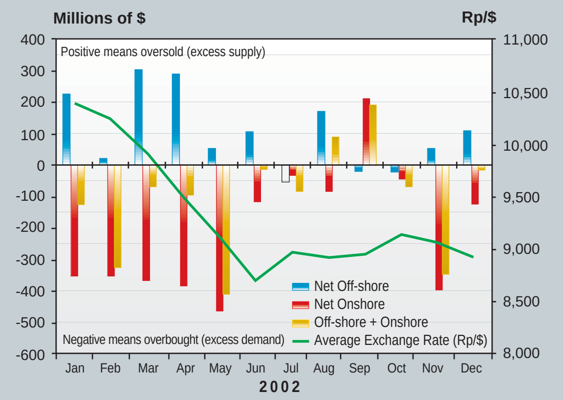
The various factors affecting the rupiah, noted above, were reflected in the demand and supply

5 Daily exchange rate deviation from its 22-day moving average (1 calendar month).

conditions of the foreign exchange market. During the reporting period, the demand for foreign exchange by corporations (particularly by state-owned enterprises as big players) was still quite strong, although it was partially met by proceeds from IBRA asset sales. Buying by these big corporations often triggered demand in the foreign exchange market (see Box : The Impact of the Main Market Players on the Exchange Rate). Demand for foreign exchange by these main players was even stronger during semester II with average net buying of $454.5 million each month, up from $304.6 million in semester I-2002. This rising demand was in line with the appreciating trend of the rupiah exchange rate during semester I-2002, which shifted to a trend of depreciation in semester II-2002.

High demand for foreign exchange by those corporations was also reflected in the pattern of foreign exchange transactions between banks and their customers. On-shore customers recorded a net dollar overbought position of $2.5 billion, while the off-shore customers recorded a net dollar oversold of $1.2 billion; overall customers' net overbought positions toward banks in the spot market was $1.3 billion during the reporting period.[6] On the other side of these transactions, banks recorded a net oversold position of $1.3 billion. The banks' oversold position was in line with the oversold position of off-shore customers, suggesting that off-shore customers were the market maker and they were followed by banks taking the same position.

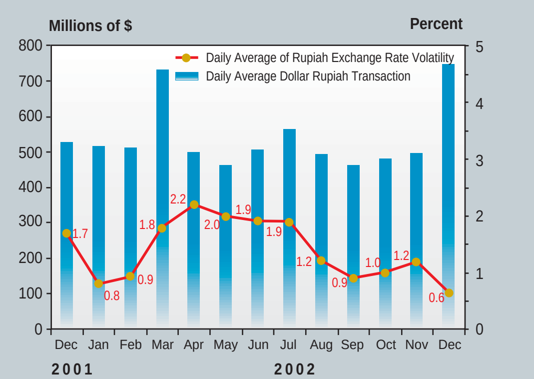
Supply flows of foreign exchange from off-shore customers recorded a net oversold position from January through June 2002, which became the cause of the



Graph 3.8
Supply and Demand for Foreign Currency (Spot Market)

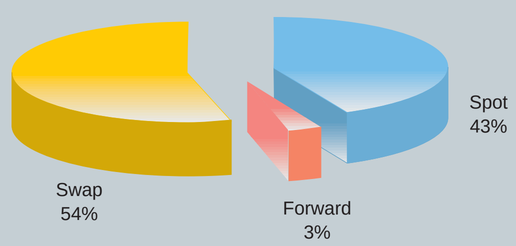
rupiah appreciation in semester I-2002 (Graph 3.8). However, the supply of off-shore customers started to decline at the beginning of semester II-2002, as reflected in off-shore customers' net overbought position. This generated depreciation pressures on the rupiah in semester II-2002.

In the meantime, the volume of interbank foreign exchange transaction in the spot market (on a daily average basis) increased slightly from $517.7 million in the previous period to $538.2 million in the reporting period (Graph 3.9). The increase in the daily volume of transactions took place after the Bali tragedy, which

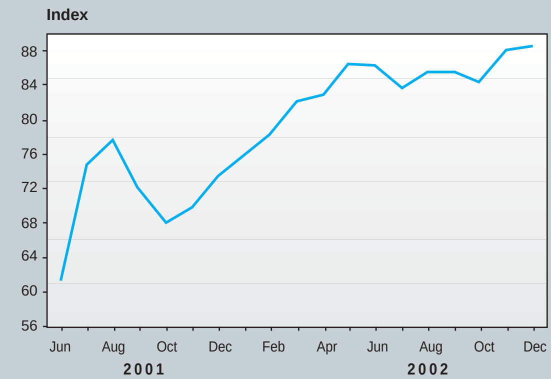


Graph 3.9
Volume of Spot Transaction and Exchange Rate Volatility

6 Overbought refers to a condition where buying of foreign exchange is higher than selling. Oversold is the reverse condition.



Graph 3.10
Composition of Dollar-Rupiah Interbank Transaction



Graph 3.11
Real Effective Exchange Rate

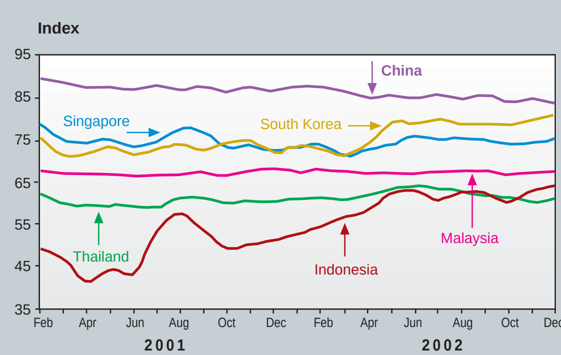
triggered panic buying. Foreign exchange transactions surged to $786.8 million on October 14, 2002.

By type of transaction during 2002, interbank transactions were still dominated by swap transactions, which cumulatively reached $146.0 billion or 54% of total transactions. Spot and forward transactions amounted to $117.2 billion and $7.1 billion, respectively (43% and 3%, of total inter-bank foreign exchange transaction) during the same period (Graph 3.10). Total foreign exchange volumes (spot, forward and swap transactions) amounted to a 5.5% decline from $286.1 billion in 2001 to $270.3 billion in 2002. Interbank foreign exchange transactions were still dominated by foreign banks. The share of 5 big players (consisting of 4 foreign banks and 1 private bank) amounted to 55.8% of total interbank foreign exchange transactions in the reporting period.

THE REAL EXCHANGE RATE

During the reporting year, the real rupiah exchange rate remained undervalued (Graph 3.11). Nevertheless, the rupiah appreciated during the reporting year, as reflected in a rising REER index from 73.52 at the end of 2001 to 88.57 at the end of the reporting year. This appreciation was in line with the nominal appreciation of the rupiah.

On a bilateral basis, the rupiah exchange rate was quite competitive in supporting exports compared with currencies of other emerging countries in Asia, except for the Thai baht. Indonesia's Bilateral Real Exchange Rate (BRER) index rose from 51.47 at the end of 2001 to 64.13 at the end of the reporting period (Graph 3.12), which is now substantially above Thailand's BRER (60.97). However, the rupiah remained more competitive than the Malaysian ringgit, Singaporean dollar, Korean won, and China yuan.



Graph 3.12
Bilateral Real Exchange Rate

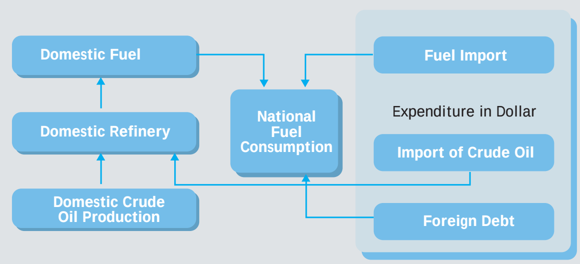
box

The Impact of Major Market Players on the Exchange Rate

Amidst the appreciating trend of the rupiah exchange rate in 2002, purchases of foreign exchange by major market players was a factor triggering depreciation and increasing volatility of the exchange rate. This was due in part to the impact of major players' transactions in affecting the behavior of other market players. In general, foreign exchange transactions by major players represent genuine demand for financing purpose in the process of production. Meanwhile, in addition to their genuine demand, other market players also grabs the momentum for speculative purposes. On the whole, transactions by market agents are a dominant factor in determining developments of the exchange rate.

As in 2001, the dominant market players were several state-owned corporations with significant demand in the market. Throughout the reporting period, foreign exchange transactions by major market players were quite sensitive to shifts in sentiment, both domestic and foreign. The lowest dollar exchange rate around mid-year, following by negative regional sentiment had encouraged higher demand for dollar by those major players. This behaviour is then followed by other players, created snowball effect at domestic foreign exchange market. Therefore, the originally genuine demand had influenced other players to buy dollar, either for their genuine demand or speculation. Indeed, several market players were over-responsive, buying aggressively, even before purchases by the corporations.

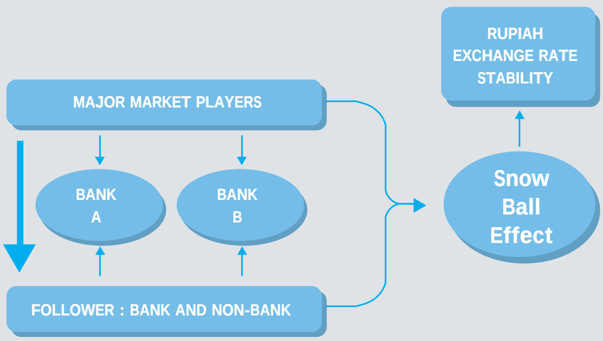
Major Corporate Demand for Foreign Exchange



On the side of the major corporations, their demand for foreign exchange from the market is estimated to be huge, because oil/gas exports have not been adequate to meet the operational needs of financing crude oil imports and their distribution. In addition, other state-owned corporations also needed foreign exchange to finance the procurement of electricity, although with lesser amount and lower frequency. Besides importing raw material, corporate purchase of foreign exchange is aimed to meet other obligations, such as repayment of foreign debts, which tended to rise in 2002.

There were also other normal multiplier effects on the market player bases. The needs of foreign and domestic customers have boosted interbank transactions, which is a derivative to meet those need by the market. In 2002, customer trans-

The Multiplier Effect of Foreign Exchange Market



actions averaged $349 million per day and pushed interbank transactions up to $546 million per day, which is a multiplier of 1.5 and close to that of the previous year. This multiplier effect adds to the volatility of the rupiah exchange rate.

These various factors are indicative of the tight constraints faced by Bank Indonesia in managing the exchange rate, despite the appreciating trend and relatively low volatility in 2002.

CHAPTER 4
Annual Report

Inflation

CHAPTER

4 INFLATION

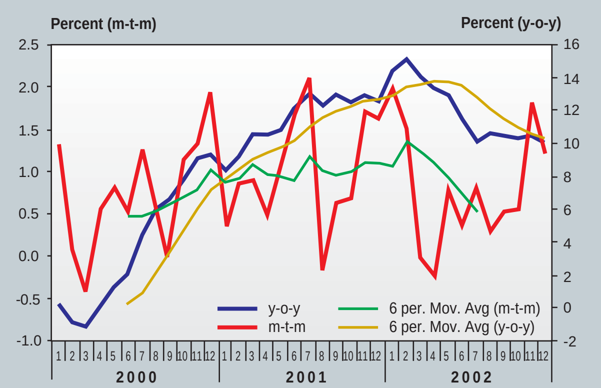
Inflation declined during 2002 in line with the appreciation of the exchange rate, declining inflationary expectations by the public, and insignificant aggregate demand pressure.

During 2002, several measures of prices (namely, the Consumer Price Index (CPI) inflation, core inflation, the Wholesale Price Index (WPI), the Asset Price Index (API), and the GDP deflator) indicate that inflation declined from the previous year. Lower inflation during the reporting year was mainly due to strengthening of the rupiah exchange rate (accompanied by low volatility) and declining inflationary expectations. Domestic demand was not a source of significant inflationary pressure, partly due to higher inflows of imported consumption goods.

CPI inflation,[1] which is the basis for Bank Indonesia's inflation target, slowed appreciably during 2002, although it remained slightly above-target. Above target inflation during the reporting year resulted from increases in administered prices and government incomes policies. The public's inflationary expectations have declined somewhat, but they remain high.

DEVELOPMENTS IN INFLATION INDICATORS

Inflation during 2002 was recorded at 10.03% (y-o-y), lower than the previous year's 12.55%. The decline mainly occurred in the first semester when the drop was quite sharp, although it was abated in the second semester. On a monthly basis, the highest inflation was in January and followed by disinflation in March and April (Graph 4.1).



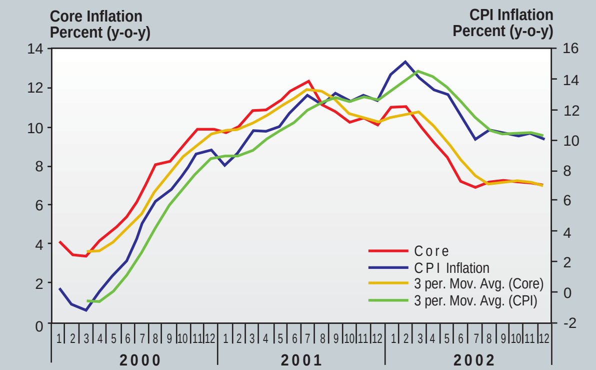
Graph 4.1
Annualy and Monthly CPI Inflation

The downward trend of inflation was clear in the core inflation measure using the exclusion method.[2] On this basis, core inflation had been increasing since early 2000, but it turned downwards in mid-2001 and continued to decline during 2002. By year end it was down to 6.96% compared to 10.04% a year previously. However, due to the administered prices impact, the drop in ''headline' CPI inflation was slower than that of the core inflation (Graph 4.2).

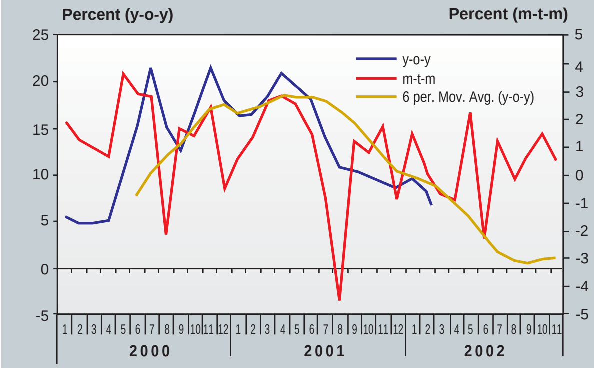
The downward trend of inflation was confirmed by other price indicators, such as the WPI and the API. Inflation as measured by the General WPI has been

1 Elsewhere in this report, CPI inflation is simply referred to as inflation.

2 Elsewhere in this report, core inflation is defined as core inflation using the exclusion method unless otherwise mentioned.



Graph 4.2
CPI Inflation and Core Inflation

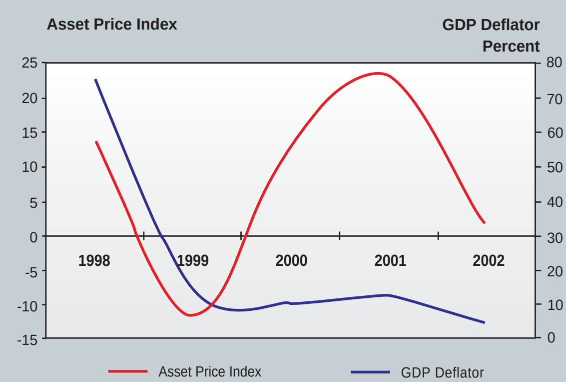


Graph 4.3
General Wholesale Price Index (WPI)

declining (on an annual basis) since early 2001, including with a sharp price drop in June by 3.33% (Graph 4.3). On a monthly basis, sharp drops in WPI inflation were recorded in March, April, June and August. These sharp price drops were due to significant deflation in the import and export categories, which was in line with significant appreciation of the rupiah exchange rate.

Similarly, the rate of asset price inflation (as measured by the change in the annual API (y-o-y)) dropped steeply from 23.09% during 2001 to 1.52% during 2002 (Graph 4.4). This small increase of 1.52% in 2002 was mainly due to a major drop in the rate of change of the rental price of commercial property, namely from 39.69% during 2001 to –3.68% during the reporting year. The decline in commercial property prices was mainly associated with the strengthening of the rupiah exchange rate since most commercial property is priced in dollar. Another large component of asset price inflation, namely residential property, recorded lower inflation in 2002, but prices did not drop. Residential property prices during the reporting year increased by 6.95%, down from 10.86% during 2001. Higher residential property prices mainly occurred in large houses located in Jakarta and its vicinity. In line with property price developments, financial asset prices (represented by the Jakarta Composite Index; JCI) also declined. The lower JCI was partly due to unfavorable domestic developments; it was also due to weak regional and world stock markets.

The GDP deflator, a price indicator with wider coverage, was also on a declining trend in 2002. The GDP deflator put inflation at 4.54% (y-o-y), lower than 2001 (12.58%). These developments indicate that declining inflation constituted a general trend occurring throughout the whole reporting year.



Graph 4.4
Asset Price Index and GDP Deflator

DEVELOPMENTS IN CPI INFLATION

As mentioned earlier, inflation has been on a declining trend for some time. Nonetheless, inflation during 2002 (10.03%) was slightly higher than Bank Indonesia's CPI target range of 9%-10% for 2002.

During the first semester of 2002, inflation came down markedly. This was mainly due to appreciation of the exchange rate and declining inflationary expectations. The exchange rate appreciated significantly during that period and was accompanied by low volatility, which held down inflationary pressures from the external side. The appreciating rupiah was particularly apparent in the traded goods category of the CPI; those prices declined significantly in the middle of the reporting year.

Declining inflationary expectations are reflected in the consumer survey, which includes expectations regarding price developments in the coming 6 to 12 months. This survey indicates that consumers' inflationary expectations declined due mainly to the rupiah appreciation and anticipated improvements of economic conditions.

The decline in inflation was also supported by the supply of public basic needs, particularly rice. Rice market operations conducted by National Logistical Agency (Bulog) and abundant imports pushed down rice prices. The price of rice, which peaked in early 2002, was lowered gradually and it stabilized at Rp2,790 per kg.[3] At the end of the reporting year, Bulog's rice stock amounted to 1.75 million tons or enough to supply routine distribution needs for around 7 months.[4]

3 Source: Bulog
4 Source: Press announcement of the Coordinating Minister Office of Economic Affairs, 29 November 2002.

The decline of inflation during the first semester of 2002 was abated by increases in government administered prices and incomes policy. The policy to reduce subsidies on fuels, telephone tariffs and the base electricity tariff during that period had the direct impact of increasing the prices of those items to consumers. In addition, higher prices for fuel and electricity pushed up the prices of other goods and services due to cost-push factors. Also, higher prices set by the government increased inflationary expectations.

In the second semester of 2002, the decline in inflation abated slightly. This was mainly due to seasonal factors namely the religious festivities; continued rise in administered prices; and rising inflationary expectations. As in previous years, inflation pressures were high during the religious festivities and at year-end.

Government pricing policy contributed significantly to inflation during the second semester of the reporting year, due to higher electricity tariffs, fuel prices, retail prices of cigarettes, and LPG prices. Another factor limiting price declines at the end of 2002 was rising inflationary expectations. Survey outcomes showed that consumer price expectations were rising in the last quarter of 2002, triggered by higher administered prices, depreciation of the rupiah following the Bali tragedy, and seasonal factors related to religious festivities and the New Year. In addition to affecting consumers' inflationary expectations, these various developments also triggered higher inflationary expectations among merchants. Based on the retail sales survey, traders' inflationary expectations rose at the end of 2002, triggered mainly by higher administered prices. Other factors in this regard included seasonal factors and the normal pattern of higher traders' prices to take advantage of high demand during the religious festivities.

By category, housing made the largest contribution to inflation during 2002, followed by food materials, transportation and communications, and processed food, beverages, and cigarettes (Table 4.1); clothing made a low contribution. The contribution of housing was mainly due to residential costs, including electricity, housing rent, and servant salaries, which increased significantly during the reporting year. Looking at the rise in prices among the broad categories, transportation and communications recorded the highest inflation (15.52%). This mainly originated in rising prices of transportation sub-categories (prices for fuel, diesel, and transportation tariffs) and communications sub-categories (telephone tariffs).

By city, the highest inflation was recorded in Manado (15.22%) and the lowest in Ternate (6.40%). However, the largest contribution to overall inflation comes from a few major cities, mainly Jakarta (3.09%) and Surabaya (0.74%), because their weights in the index are large.

(Percent)

Table 4.1
Contribution of CPI Inflation by Category in 2002

No	Category	Inflation	Contribution
1	Foodstuff	9.13	2.36
2	Processed Food, Beverages, Cigarettes, and Tobacco	9.18	1.72
3	Housing	12.71	2.79
4	Clothing	2.69	0.26
5	Health	5.63	0.31
6	Education, Recreation, and Sport	10.85	0.82
7	Transportation and Communication	15.52	1.77
	Total		**10.03**

Source: BPS-Statistic Indonesia

FACTORS AFFECTING INFLATION

Impact of Government Policy on Prices and Incomes

Regarding prices, the government continued to gradually adjust prices of a number of goods closer to market rates. The policy on incomes was aimed at maintaining the public's purchasing power, especially those who are on fixed incomes. In 2002, government policy on prices and incomes had a significant impact (3.31%) on overall inflation, although it was down from 2001 (3.83%).

By year-end, the overall impact on inflation of government prices and income policies was higher than assumed in early 2002 (2.57%). This was mainly due to: (i) price/tariff setting that had not been identified by early 2002; (ii) a change in the mechanism for determining the rise in fuel prices; and (iii) actual price/tariff increases that were higher than assumed early in the year (Table 4.2).

Government pricing policies that were not known in early 2002 included: rises in LPG prices in June and December; higher business and executive class train tariffs in February; increases in city transportation tariffs in a number of cities; and higher tariffs for clean water. Increases in these prices were not announced early in the reporting year.

The setting of fuel prices changed in 2002, to a monthly basis. Based on Presidential Decree No.9, 16 January 2002 on Domestic Fuel Price Setting, the domestic fuel price is set by Pertamina on the first day of the current month,[5] with reference to the price of Mid Oil Platt's Singapore (MOPS), which monitors the

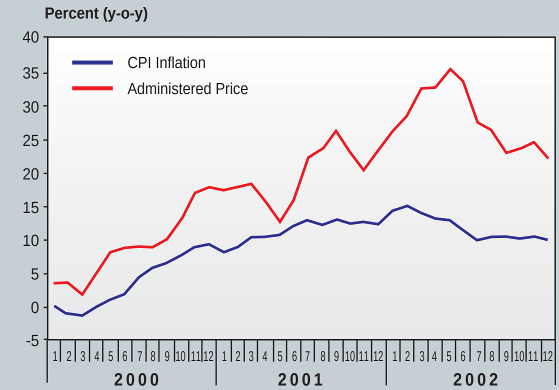
5 Based on Presidential Decree No. 27/2002, 30 April 2002, article 6, among others, to change the fuel price on an early date of every month.

(Percent)

Table 4.2
The Realization of Government Price and Income Policies in 2002

Government Policies	Price/Tariff Increase	Inflation Impact
Price Policy		
Electricity	38.51	0.74
Fuel	21.74	0.40
Transportation *)	18.69	1.10
LPG Gas	24.34	0.10
Telephone Tariff	41.13	0.51
Water Clean	9.54	0.05
Cigarettes	4.24	0.19
Income Policy		
Provincial Minimum Wages	18.10	0.22
Total		3.31

Note: *) Including indirect impact
Source: BPS-Statistic Indonesia (processed)



Graph 4.5
CPI Inflation and Administered Price

buy-sell prices in the Singapore oil market. In addition, this Presidential Decree (Keppres) set an effective floor and ceiling price for every type of fuel in order to avoid big domestic fuel price fluctuations. On this basis, fuel prices can fluctuate and have an impact on the CPI every month. Previously, fuel prices would only change once or twice a year.

For their part, the base electricity tariff (TDL) and the telephone tariff increased more than initially estimated. During 2002, TDL in the CPI basket increased by 38.5%, much more than the initial plan of 6.0% every quarter or 24.0% per year. Likewise, telephone tariffs in the CPI basket increased by 41.1%, much higher than the initial plan of 15.0% on average.

Not all prices/tariffs set by the government had a larger impact than initially estimated. For example, the (minimum) retail sales price for cigarettes rose by 22.0%, but the cigarette price in the CPI basket only increased by around 4.2%, on average. This was due to a number of cigarette companies already having priced their product above the new minimum retail price.

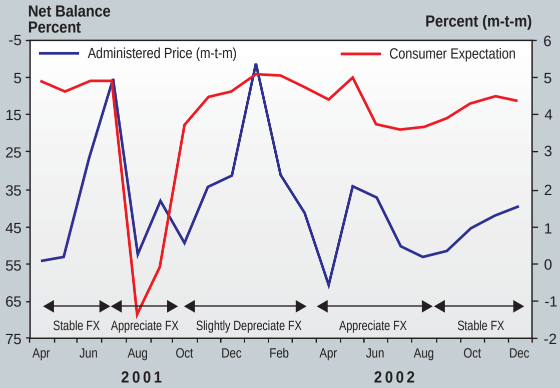
Also, the minimum provincial wage (Upah Minimum Propinsi/UMP) also had a smaller inflationary impact than expected because the actual increase in UMP was lower than anticipated at the beginning of 2002.

The inflationary impact of government policies on prices and incomes can be clearly seen in the development of annual inflation for the administered prices category, which was much higher than overall CPI inflation (Graph 4.5). Administered price inflation peaked in May 2002 at 35.66% (y-o-y) and ended the year at 22.12% (y-o-y).

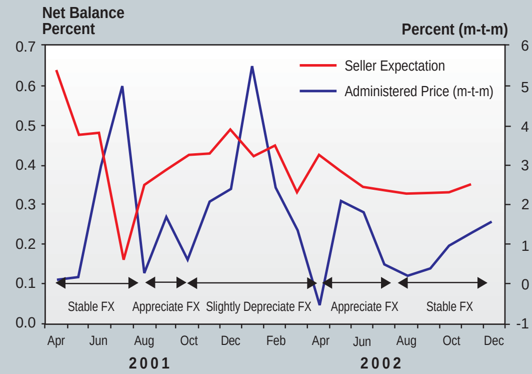
Impact of Expectations

Bank Indonesia announced a target for inflation of 9%-10% for 2002 with the purpose of directing inflationary expectations of the public (consumers and traders) towards the targeted rate. Hopefully, this inflation target could become the anchor for economic agents' actions, that is, for consumers in spending their income and for traders in calculating their costs and setting prices for their products.

As 2002 developed, inflationary expectations tended to improve as indicated by the consumer and



Graph 4.6
Consumer Survey on Inflation Expectation



Graph 4.7
One Month a Head Price Inflation Expectation

retail sales surveys (Graph 4.6 and Graph 4.7).[6] Lower expected inflation for consumers and traders is in line with the appreciation of the rupiah exchange rate and the rise in the supply of goods. However, on a quarterly basis, expected inflation worsened slightly after QIII-2002. This was triggered by the rupiah depreciation, government pricing policies, and seasonal factors associated with religious and New Year festivities.

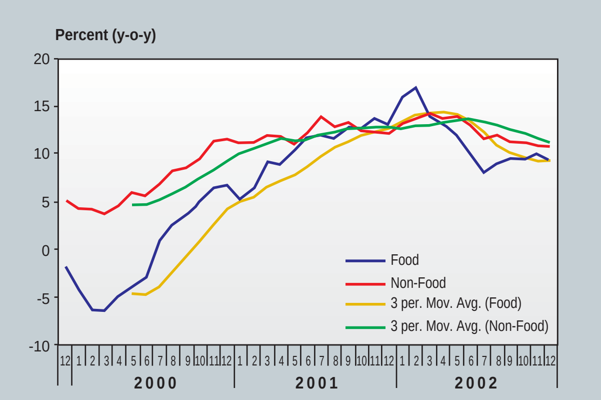
Although inflationary expectations have decreased, they remain at a high level. This is partly due to the formulation of public expectations regarding inflation, which are adaptive in nature. That is, the expectations formation process is based upon inflation developments in recent periods. With high inflation (double digit) last year, the public expected high inflation to continue in 2002.

Other factors affecting the public's expectations towards inflation include movements of the rupiah exchange rate. Graphs 4.6 and 4.7 show the development of (consumers' and traders') inflationary expectation in line with movements in the rupiah exchange rate. As the exchange rate strengthened, inflationary expectations also tend to decline. Likewise, when the exchange rate was under pressure, inflationary expectations tend to worsen. Also, the implementation of government policies on prices and incomes affected inflationary expectations during 2002. Early in the year, these expectations tended to be high (despite an appreciation of the rupiah), because the government announced a policy to raise prices of a number of goods and services. However, the policy was only undertaken gradually, so that the public's inflationary expectations moderated somewhat. However, inflationary expectations tended to worsen during the following period in line with government pricing policy.

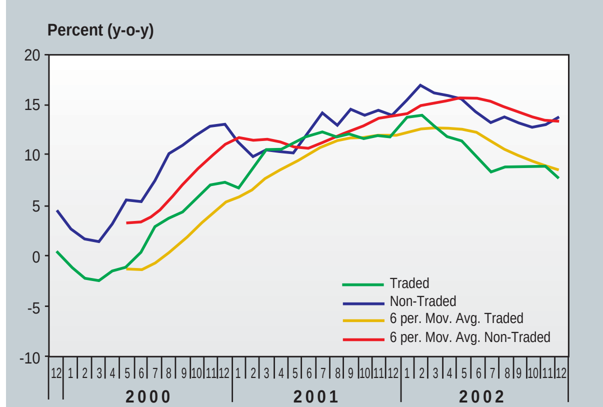
Impact of Demand and Supply Conditions

During the reporting year, interaction between aggregate supply and demand did not lead to significant inflationary pressures. In 2002, growth in demand was dominated by household consumption spending, mainly non-food spending. Indeed, this has been the tendency

6 Indicators used to evaluate consumers' and traders' inflationary expectations are derived from results of the Consumer Survey and the Retail Sales Survey done by Bank Indonesia.



Graph 4.8
Food and Non-food Inflation



Graph 4.9
Traded and Non-traded Inflation

since the end of 1998; by 2002 the proportion of non-food consumption was already high (compared to consumption spending on food).[7] However, this has not put significant pressure on non-food prices because of adequate, timely supplies. Inflationary pressures in this regard were due more to other factors, such as administered prices (Graph 4.8).

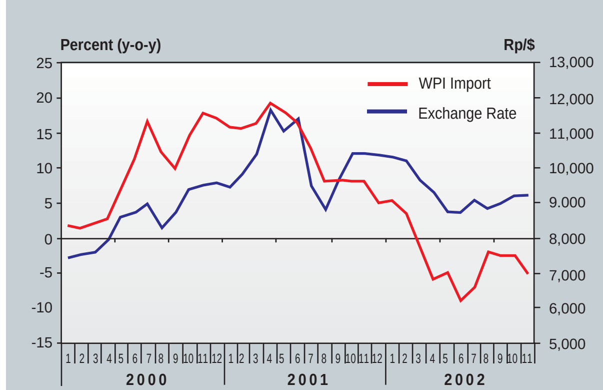
On the supply side, low levels of gross investment meant that aggregate economic capacity did not expand much in 2002. Nonetheless, inflationary pressures from this side were not significant in the reporting year, because demand increased only moderately; the agricultural sector maintained food supplies; and there were additional supplies of consumption goods from abroad.

Impact of External Factors

External factors affecting inflation included the rupiah exchange rate and the price of imported goods. The rupiah generally strengthened during the reporting year, helping to reduce inflationary pressures. The impact in this regard can be seen in the movements of the wholesale price index and traded goods inflation (Graph 4.9). Meanwhile international prices declined for a number of important commodities (such as rice and sugar). The wholesale price index of imports and traded goods inflation slowed during 2002; indeed, the wholesale price of imports has experienced deflation since March 2002 (Graph 4.10).

Impact of Natural Disasters

In the reporting year, there were major floods in several areas that are production centers for food or important links in the domestic transportation network



Graph 4.10
Wholesale Price Index and Exchange Rate

7 In percentage of GDP at 1993 constant prices.

(including Jabotabek, East Java and North Sumatra). These floods disrupted economic production and the distribution network, which caused high inflation in February 2002, namely 1.50% (m-t-m). By way of comparison, the average for February during the previous 3 years was below 1%. Normally, this period is the peak of domestic supply of food relative to demand.

By the end of 2002, production of several agriculture commodities was down to a low level. The dry season, including a relatively low-intensity El Nino, caused a drought along much of the coast of Java and other centers of food supply, especially for vegetables. These conditions increased inflationary pressure towards the end of the reporting year.

CHAPTER 5 Annual Report

Monetary Developments

CHAPTER 5

MONETARY DEVELOPMENTS

During 2002, monetary conditions was conducive as reflected in controlled base money, strengthened exchange rate, and declined interest rates.

During 2002, monetary policy remained directed at controlling base money in line with real demands of the economy. This policy aimed at maintaining price stability in order to support the on-going economic recovery. The strategy used to implement the policy, during 2002 was to absorb excess liquidity in the banking system while attempting to lower interest rates. For this purpose, Bank Indonesia set the target for average base money growth within a range of 13%-14%.

As 2002 developed, base money remained under control, as reflected in growth below its target. The test date position[1] of base money was always below its indicative target in 2002. Such relatively slow growth of base money was largely attributable to lower precautionary motives for holding currency, as the public's evaluation of monetary and socio-political conditions improved. This positive evaluation of monetary stability was forming at the same time that other macro indicators (such as inflation and the exchange rate) were also improving. In the meantime, other main monetary aggregates, such as M1 and M2, were growing at a slower pace.

These positive developments served to improved inflationary prospects, and therefore providing Bank Indonesia with more room to signal a gradual decline of interest rates through reductions in the rates on its monetary instruments (SBI and FASBI). These were implemented carefully, including with close attention to the movements of real interest rates and interest rate differentials.

Lower rates on monetary instruments were followed by reductions in several other interest rates. In that regard, inter-bank money market and bank deposit interest rates experienced significant declines, although rates on working capital and investment credit did not decline by any meaningful extent. By contrast, interest rates on consumer credit actually increased a little. The minor reductions in rates on investment credits stemmed from continuing bank's perceptions of high risk in the extension of long-term credits.

The declining trend of most interest rates and relatively rigid rates on banking credits have driven a number of reputable corporations to issue bonds in the domestic (and international) capital market, also make initial public offerings (IPOs) and right issues in the local stock market. On the demand side, bonds and mutual funds became more interesting alternative investments as interest rates on savings deposits declined.

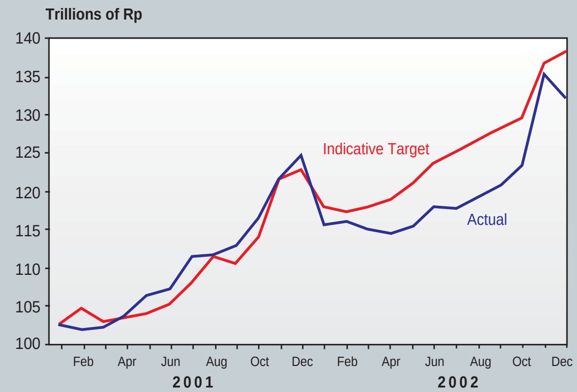
1 The test date position of base money is the average of base money calculated from the 16th of the given month up to the 15th of the following month.

EVALUATION OF MONETARY POLICY IN 2002

At the beginning of the year, Bank Indonesia set its target for monetary growth during year 2002; base money was targeted to expand at an average growth of 13%-14%. The target was set based upon a CPI inflation target of 9%-10%; forecast economic growth of 3.5%-4.0%; and an average exchange rate assumption of Rp9,500 - Rp10,500 per dollar. With those base money growth target, it was expected that the inflation target could be met, with liquidity consistent with the outlook for economic growth and the exchange rate.

In implementation, monetary policy took note that inflationary pressures were largely due to supply side constraints and government pricing policies (cost push). Consequently, monetary policy during 2002 was directed at efforts to absorb excess liquidity in the banking system while nurturing a development of interest rates that would send conducive signals for improvements in the supply side in the real sector. The emphasis on liquidity control (through the absorption of excess liquidity in the banking system) was in line with the fact that base money growth was largely determined by the demand for currency,[2] which is only influenced indirectly through OMOs'. This strategy was translated into SBI interest rates that declined modestly as long as future inflationary pressures stayed within the target range. Operationally, monetary policy was implemented by optimizing BI's existing monetary instruments, primarily OMOs and foreign currency operations/ sterilization.

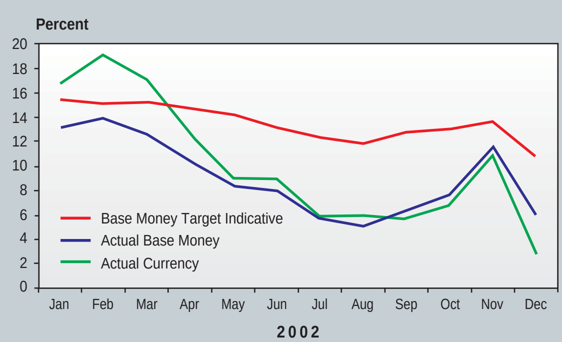
2 Currency includes coins and bank notes that are circulating among the public.



Graph 5.1
Base Money: Indicative Target and Actuals

During 2002, base money was under firm control, as reflected in low test date growth relative to the indicative target (Graph 5.1). This was mainly due to eased precautionary demand for money in line with positive perceptions of monetary and socio-political stability. In addition, there was lower demand for money for transactions as economic growth was lower and the exchange rate firmer than anticipated at the beginning of the year (Graph 5.2).

Controlled expansion of base money, along with lower inflationary prospects and a relatively stable exchange rate, enabled Bank Indonesia to signal gradual

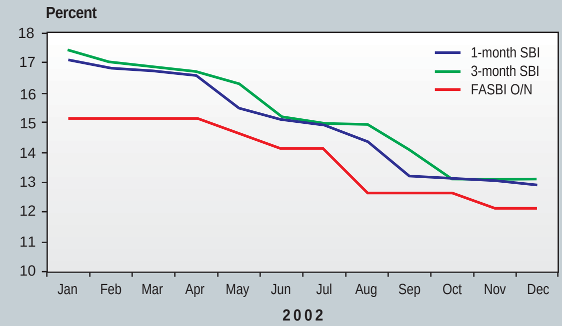


Graph 5.2
Currency and Base Money Growth: Actuals and Indicative Target

interest rate cuts, which in turn would accelerate the economic recovery.

The signals of interest rate cuts were primarily lower interest rates of Bank Indonesia Deposit Facility (Fasilitas Simpanan Bank Indonesia/FASBI),[3] followed by lower rates on SBIs. During 2002, the O/N FASBI interest rate was lowered 5 times, for a cumulative of 300 bps; by the end of December 2002, it was down to 12.13%. For their part, 2- to 6-day and 7-day FASBI interest rates were cut by 300 bps and 338 bps respectively, falling to 12.38% and 12.50%. Also during 2002, 1- and 3-month SBI rates dropped by 469 bps and 451 bps, respectively, to 12.93% and 13.12% by year-end. With these sharp declines, by the end of 2002 interest rates on 1- and 3-month SBIs were lower than at the end of 2001. The declines in SBI interest rates were much sharper between January and the beginning of September 2002; relative to the decline from October until the end of 2002 (Graph 5.3).

Operationally, the strategy of monetary policy during 2002 was to pay close attention to quarterly developments in macroeconomic and monetary conditions. In the first quarter, taking into account that at the end of 2001, base money was relatively high and that currency-in-circulation would return to the banking system after the religious holiday festivities, Bank Indonesia made efforts to optimally absorb liquidity, especially through OMOs. The objective was to maintain base money within its indicative target. Liquidity conditions in the banking sector at the beginning of the year enabled 1-month SBI interest rates to drop quite significantly, by 86 bps, after continuous increases



Graph 5.3
Interest Rates on Monetary Instruments

during 2001. Nevertheless, as inflation was relatively high and the exchange rate relatively weak, during this period Bank Indonesia continued to act prudently by keeping FASBI interest rates unchanged (neutral bias).

Entering the second quarter, base money fell below its indicative target, while the exchange rate and inflation improved. These positive developments provided room for Bank Indonesia to send signals of interest rate cuts in order to sustain the momentum of economic recovery while still achieving the inflation target (accommodative policy). Signals of interest rate cuts were provided through reductions in FASBI rates for all tenors in May and June, by 50 bps on each occasion. Consequently, these declines in FASBI rates were accompanied by lower interest rates on 1- and 3-month SBIs by 165 bps and 171 bps, respectively, during the second quarter. Lower interest rates on SBIs were supported by liquidity conditions in the banking sector, which had substantial excess liquidity due to continued bank disintermediation. Despite these interest rate declines, base money (measured on its test dates) remained below its indicative target during the second quarter.

3 Prior to November 2002, this facility was known as Contractive Rupiah Intervention, or simply Rupiah Intervention.

In line with the positive trend of monetary developments, in the third quarter efforts intensified to strengthen signals for interest rate cuts, particularly through further lowering of O/N FASBI interest rate by 150 bps. At the same time 1- and 3-month SBI interest rates were down by another 189 bps and 107 bps, respectively. As was the case in the preceding quarter, base money (test date position) remained below its indicative target, despite the SBI rate cuts.

In an effort to strengthen FASBI's function as a monetary control instrument, in September 2002 Bank Indonesia adjusted the trading periods of O/N FASBI into morning and afternoon sessions, applying different interest rates for each session. The morning session runs from 08:00 to 12:00 West Indonesia time, while the afternoon session runs from 13:00 to 16:30 West Indonesia time. The interest rate on O/N FASBI for the afternoon session was set at half of that of the morning session. Furthermore, FASBI trading for all other tenors was conducted only during the morning session.

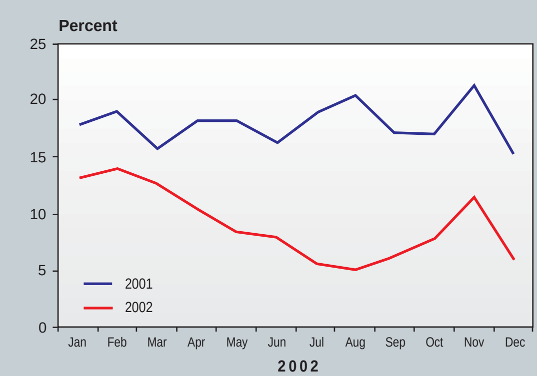
Considering that SBI interest rates had already declined sharply and reached relatively low levels consistent with attainment of the inflation target, in the fourth quarter Bank Indonesia attempted to slowdown the pace of SBI interest rate reductions. This monetary policy was also implemented in light of the rupiah weakening stemmed from the Bali tragedy . After the exchange rate rebounded and considering that inflationary prospects continued to improve, at the end of November Bank Indonesia moved again on FASBI rates, lowering all tenors by 50 bps. For its part, the 1-month SBI interest rate fell by only 29 bps in the fourth quarter, from 13.22% at the end of September to 12.93% at the end of December.

BASE MONEY AND CURRENCY IN CIRCULATION

Base Money

In 2002, the test date position of base money always stayed below its indicative target. The deviations varied between Rp1.3 trillion to Rp7.7 trillion, with the widest gap in August and the smallest in November. For the year as a whole, the average annual growth of base money was only 9.6%, down from 17.9% during the preceding year (Graph 5.4).

By the end of December 2002 base money had reached Rp138.3 trillion, or Rp10.5 trillion above its position at the end of December 2001 (Rp127.7 trillion; Table 5.1). Viewed by component, this rise largely originated in a Rp4.4 trillion rise in currency and a Rp3.4 trillion rise in commercial banks' current account positive balance at Bank Indonesia. The rise in currency was largely due to a surge in public needs in conjunction with Idul Fitri, Christmas and New Year's. Meanwhile, the rise in commercial banks' current account positive balance at Bank Indonesia was mainly due to a rise in minimum reserve requirements (GWM) in light of expanded banks' third party funds. The rise in base money also



Graph 5.4
Annual Growth of Test Date Base Money

(Trillions of Rp)

Table 5.1
Base Money

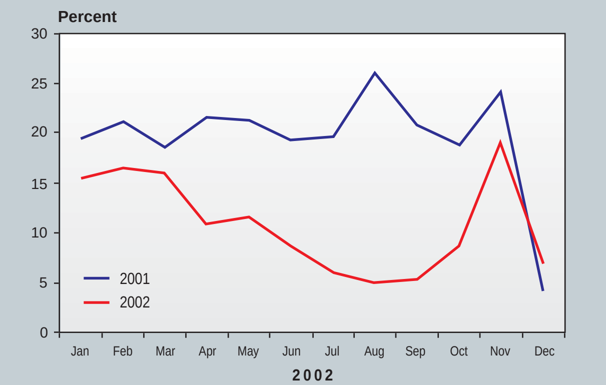
Item	2001	2002				Annual Change
	Dec	March	June	Sept	Dec	
Base Money	**127.8**	**117.0**	**119.9**	**123.9**	**138.3**	**10.5**
Bank notes and coins outside	91.3	82.4	84.5	86.3	98.4	7.1
public	76.3	69.7	72.0	72.8	80.7	4.4
bank	14.9	12.7	12.5	13.6	17.7	2.7
Banks demand deposits at Bank Indonesia	34.8	33.4	34.0	36.0	38.2	3.4
Private sector demand deposits	1.7	1.2	1.5	1.5	1.6	-0.1
Factors Affecting	**127.8**	**117.0**	**119.9**	**123.9**	**138.3**	**10.5**
Net International Reserve (NIR) ($=Rp7000)	128.1	130.1	133.0	142.9	151.8	23.7
Net Domestic Asset (NDA)	-0.3	-13.1	-13.0	-19.0	-13.6	-13.2
1. Net claims on central goverment	160.8	174.6	173.2	171.2	168.5	7.8
2. Liquidity support	37.1	36.4	36.9	36.7	36.6	-0.5
3. Liquidity credit	15.1	14.9	14.7	14.5	14.4	-0.6
4. Other claims	1.9	1.9	2.2	2.3	2.4	0.5
5. Money market operation	-102.6	-114.5	-118.0	-115.9	-113.3	-10.6
6. Net other items (NOI)	-112.4	-126.4	-122.0	-127.9	-122.2	-9.7

originated in excess cash in banks' vaults (Rp2.7 trillion) in anticipation of currency withdrawals by the public.

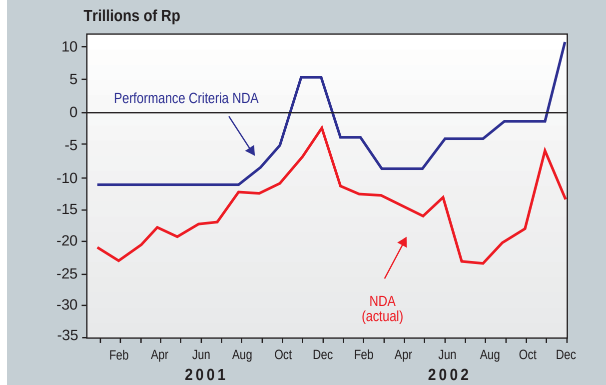
Relative to last year, currency growth in 2002 fell markedly (Graph 5.5). The average annual growth of currency was recorded at 10.9%, well below 19.6% in 2001. The main factor accounting for this slow growth during 2002 was low precautionary demand for currency, due to higher confidence associated with more stable socio-political conditions and improving trends of key macroeconomic variables (such as lower inflation rate and a firmer rupiah exchange rate).

Viewed by factors affecting base money, the growth of base money mainly stemmed from the expansionary impact of government rupiah accounts, which exceeded the contractionary effect of OMOs and foreign currency operations. During 2002, the net expansionary impact of government rupiah accounts amounted to Rp7.5 trillion.[4] This originated in, among others, expansion of government finance for payments of salaries, general allocation funds and shared revenue funds in the amount of Rp110.0 trillion; payment of bond coupons of Rp66.0 trillion; and payments on projects of Rp22.8 trillion. This expansionary effect was larger than the contractionary impact on government account stemming from, among others, tax revenues of Rp146.9 trillion; revenues from IBRA of Rp29.0 trillion; and dividend revenues of Rp11.7 trillion. The Rp7.5 trillion net expansion included the contractionary impact from the issuance of Government Securities of Rp2 trillion at the end of December 2002 (Box: Act Number 24 Year 2002 on Government Securities).

4 Net expansion of government rupiah accounts of Rp7.5 trillion was part of net claims on government (amounting to Rp7.7 trillion) that had direct influence on base money.



Graph 5.5
Growth of Currency



Graph 5.6
Net Domestic Assets

In the meantime, the net contraction from OMOs during 2002 amounted to Rp10.6 trillion. SBIs were contractionary in the amount of Rp21.9 trillion, which was partly offset by expansionary FASBIs of Rp11.3 trillion (Table 5.2). This contraction from SBIs occurred primarily in the first quarter (Rp44.4 trillion). There was less contraction in the second quarter and SBIs shifted to be expansionary in the third and fourth quarters. The relatively less contractionary stance in the second quarter and the expansionary in the third quarter were counterparts of the sharp decline in SBI rates during those two quarters. Most SBI expansion was absorbed back through FASBIs, since there were still few other more profitable placement opportunities. The large expansionary impact of SBIs in the fourth quarter was seasonal, associated with the banking sector's rising demand for short-term liquidity instruments with the approach of several religious holiday festivities and New Year's celebrations.

(Trillions of Rp)

Table 5.2
Open Market Operations and Its Components

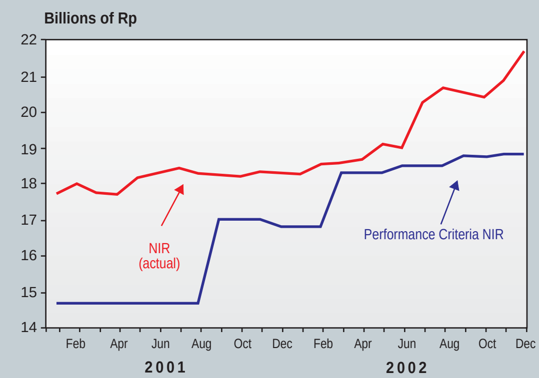
2002	Changes in OMO	Changes in SBI	Changes in FASBI
Qtr I	-11.8	-44.4	32.6
Qtr II	-3.6	-2.4	-1.2
Qtr III	2.2	4.8	-2.6
Qtr IV	2.6	20.1	-17.5
TOTAL	-10.6	-21.9	11.3

Note : (-) Contraction / (+) Expansion

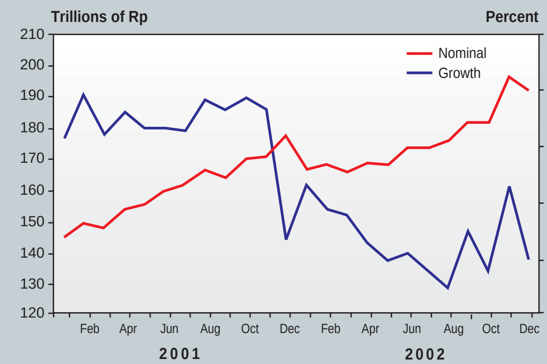
On the basis of these developments in Net Claims on Government (NCG) and OMOs, Net Domestic Assets (NDA) trended lower during 2002 and generally stayed within the limits of its performance criteria (PC).[5] At the end of December 2002, NDA was in a negative position of Rp13.6 trillion, or Rp24.5 trillion below its PC of a positive Rp10.9 trillion (Graph 5.6).

For their part, Net International Reserves (NIR) trended upwards and continued to stay above their PC.[6] By the end of December 2002, NIR reached $21.7 billion or $2.9 billion above the PC of $18.8 billion. This is up $3.3 billion from the previous year, largely due to oil and gas receipts of $4.7 billion; drawdowns of foreign debts of $2.0 billion; and proceeds from IBRA sales of $1.7 billion. These foreign currency inflows exceeded outflows, which were mainly for government foreign debt servicing of $5.0 billion.

5 The NDA performance criterion is the ceiling limit on expansion of NDA.
6 The NIR performance criterion is the floor limit for the level of NIR.



Graph 5.7
Net International Reserves



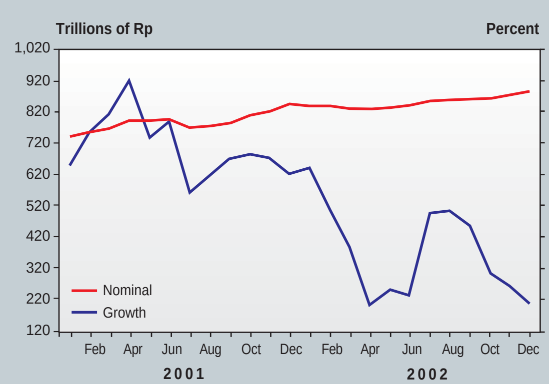
Graph 5.8
M1 Developments

Currency in Circulation

During 2002, overall liquidity (the amount of currency in circulation in narrow terms, M1, and broad terms, M2) continued to rise, albeit at a slower pace than the year before. The only exception was during the first quarter of the review year (Graphs 5.8 & 5.9). During 2002, the average annual growth of M1 and M2 were 9.9% and 8.1%, respectively, well below 19.8% and 14.7% during the previous year.[7] The slow growth of M2 was partly due to declining interest rates and limited bank lending.

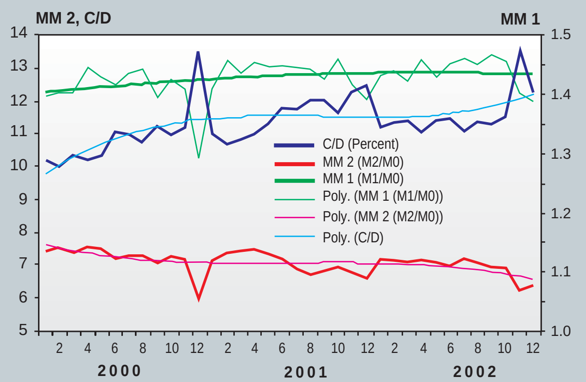
Slow growth of M1 and M2 was accompanied by relatively stable money multipliers (mm) and similarly slow base money growth (Graph 5.10). The average mm1 and mm2 in 2002 were 1.44 and 6.95 respectively, nearly the same as in 2001; these are appreciably below the pre-crisis levels of 1.75 and 7.96. On average during 2002, economic liquidity declined; real M1 and M2 were down by 1.9% and 3.5%, compared with the expansions of 7.5% and 3.0% in 2001.

By the end of 2002, M1 reached Rp191.9 trillion, which is up Rp14.2 trillion from the previous year or reaching an annual growth of 8.0% (Table 5.3). By component, this rise in M1 originated from expansions of Rp4.3 trillion in currency and Rp9.9 trillion in demand deposits. By ownership, the rise in demand deposits largely occurred in the current accounts of private corporations. Meanwhile, the Rp4.3 trillion rise in currency mainly occurred in November and December 2002 in conjunction with expanded demand for currency with the approach of religious holiday festivities and New Year's celebrations (Graph 5.12).



Graph 5.9.
M2 Developments

7 Average annual growth of M2 prior to crisis reached 24.0%



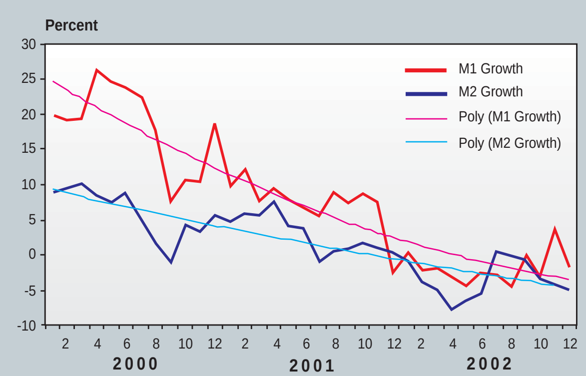
Graph 5.10
mm1, mm2, and Currency/Deposit Ratio

(Trillions of Rp)

Table 5.3
Money in Circulation

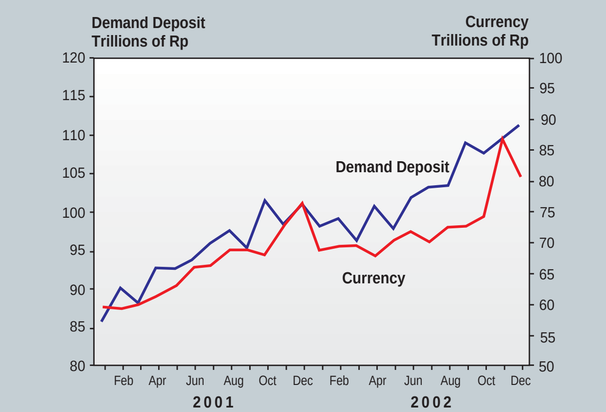
Item	2000	2001	2002	Change 2002-2001
M2	**747.0**	**844.1**	**883.9**	**39.9**
M1	**162.2**	**177.7**	**191.9**	**14.2**
Currency	72.4	76.3	80.7	4.3
Demand Deposits	89.8	101.4	111.3	9.9
Quasi Money	**584.8**	**666.3**	**692.0**	**25.6**
Time deposits in Rupiah	292.0	340.9	359.8	18.9
Saving in Rupiah	152.6	170.7	191.7	21.0
Deposits in foreign currency	140.2	154.8	140.5	-14.3
Factors Affecting M2	**747.0**	**844.1**	**883.9**	**39.9**
Net Foreign Assets	**210.7**	**234.0**	**250.7**	**16.7**
Bank Indonesia	201.2	192.6	212.4	19.8
Commercial Banks	9.5	41.4	38.3	-3.1
Net Domestic Assets	**536.3**	**610.1**	**633.2**	**23.1**
Net Claims on Central Government	**520.3**	**529.7**	**510.4**	**-19.4**
Bank Indonesia	133.7	160.8	168.5	7.8
Commercial Banks	386.6	368.9	341.8	-27.1
Claims to Business Sector	**294.9**	**329.2**	**389.3**	**60.1**
Total Credit	269.0	307.6	365.4	57.8
Credit in Rupiah	152.5	202.6	271.9	69.2
Credit in Foreign Currency	116.5	105.0	93.6	-11.4
Other claims	25.9	21.6	23.9	2.3
Others (Net)	**-278.9**	**-248.8**	**-266.4**	**-17.7**

During the same period, M2 rose by Rp39.9 trillion reaching Rp883.9 trillion at the end of December 2002 (4.7% annual growth). This rise, in addition to being attributable to the rise in M1, was also contributed by a Rp25.6 trillion rise in quasi money. By component, this rise in quasi money largely occurred in rupiah time deposits (Rp18.9 trillion) and rupiah saving deposits (Rp21.0 trillion; Graph 5.13). This rise was larger relative to the drop in foreign currency deposits of Rp14.3 trillion. Given this development, the positions of time and savings deposits at the end of the year reached Rp359.8 trillion (5.6% annual growth) and Rp191.7 trillion (12.3%), respectively. This 5.56% growth of rupiah time deposits was down from 16.8% in 2001, reflecting the downward trend of time deposit interest rates during 2002 and the growing public's enthusiasm for bonds and mutual funds, which promised greater return. Meanwhile, the drop in foreign currency savings deposits was solely due to exchange rate valuation effects stemming from the firmer rupiah. Calculated in dollars, foreign currency savings deposits went up $0.8 billion.

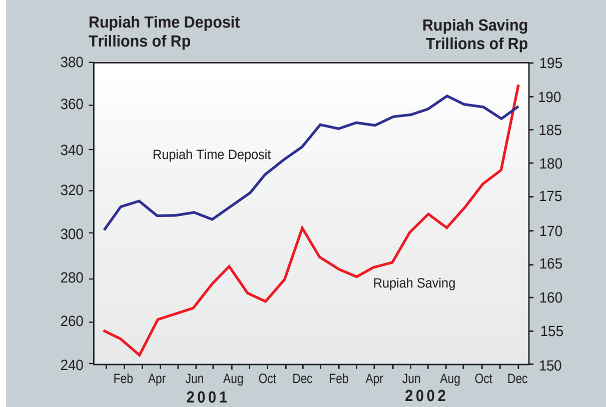


Graph 5.11
Developments of Real M1 and Real M2

Viewed by its affecting factors, M2 expansion in 2002 was due to Net Domestic Assets (NDA; Rp23.1 trillion) and Net Foreign Assets (NFA; Rp16.7 trillion). The NDA expansion stemmed from larger Net Claims on the Business Sector (CBS; Rp60.1 trillion); Net Claims on Government (NCG) contracted by Rp19.4 trillion. The



Graph 5.12
Position of Currency and Current Account Deposits



Graph 5.13
Position of Rupiah Deposits

expansion in NFA originated in Bank Indonesia's NFA, which increased by Rp19.8 trillion compared to commercial banks' NFA that contracted by Rp3.1 trillion.

The expansion in CBS resulted from increased rupiah credits in the amount of Rp69.2 trillion, largely through working capital in the industrial and business services, trading and construction sectors. In addition, the rise in rupiah credits was also attributable to a shift of credits from IBRA to the banking sector, including through the asset-to-bonds swap program.[8] Foreign currency credits dropped by Rp11.4 trillion, which was almost entirely due to the firmer rupiah; measured in foreign currency, foreign currency credits rose by $0.4 billion during 2002.

The Rp19.4 trillion contraction in NCG was more than fully accounted for by commercial banks, which shrank by Rp27.1 trillion. A relatively small part was offset by expansion of Rp7.8 trillion in Bank Indonesia's NCG. The contraction in commercial banks stemmed from cash redemptions of maturing bonds in the amount of Rp3.9 trillion, asset-to-bond swaps of Rp8.7 trillion, and a shift in ownership of recapitalized bonds from banks to mutual fund managers. Meanwhile, the NCG contraction in Bank Indonesia was mainly due to larger Government rupiah accounts, as reported previously.

As for the NFA expansion, it mainly occurred in Bank Indonesia's NIR, which was reported in detail at the end of the previous Sub-Section. As for the contribution of commercial banks, it mostly originated in lower banks' claims on non-residents, including in the forms of current accounts and call money.

MONETARY POLICY TRANSMISSION

Declines in interest rates on monetary instruments during the review period were accompanied by significant drops in interbank money market rates and bank deposit rates. However, these were not followed by proportionate drops in credit rates, especially working capital and investment credits; rates on consumer credit even went up slightly. These developments indicated that the banking sector preferred to extend short-term credits and was still reluctant to extend long-term credits.

8 The Asset-to-Bond Swap Program covers the exchange of government bonds for restructured credits or straight bonds.

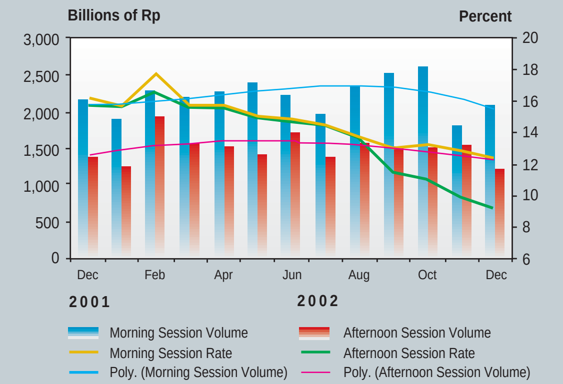
Limited amounts of long-term investment credits prompted reputable companies to seek financing in the capital market. On the supply side, lower deposit rates caused some investors to shift part of their funds into the bond and mutual fund markets, which offered more attractive coupon rates or capital gains.

Interbank Money Market Interest Rates

During 2002, the interbank money market was quite liquid, and interbank interest rates fluctuated in line with rates on Bank Indonesia's monetary instruments, in particular the overnight (O/N) FASBI (Graph 5.14). During 2002, O/N interest rates in the morning and afternoon sessions of the interbank money market fell by 348 bps and 739 bps, respectively; at the end of December, they were down to 12.42% and 8.14%. The larger decline in the afternoon session was partly due to the split of O/N FASBI into morning and afternoon sessions, with a much lower interest rate for the afternoon session.

From January through October 2002, interest rates in the domestic foreign currency interbank money market tended to be stable, before declining during the rest of the year (Graph 5.15). The foreign currency interbank rate dropped by 48 bps, from 1.73% at the end of 2001 to 1.25% at the end of the reporting year. This reflected declining interest rates abroad.

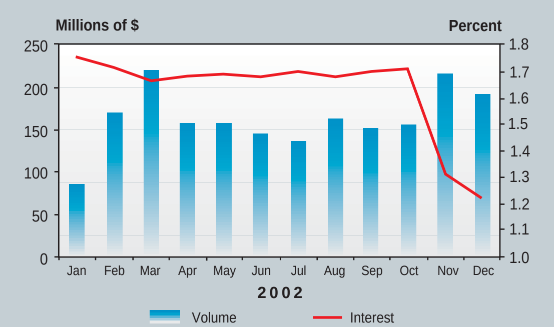
In 2002, transaction volumes in the rupiah interbank money market were somewhat higher than last year. The average daily volumes in the morning and afternoon sessions went up from Rp1.8 trillion and Rp1.4. trillion in 2001 to Rp2.2 trillion and Rp1.5 trillion, respectively. In the foreign currency interbank money market, trading volume was quite stable in 2002,



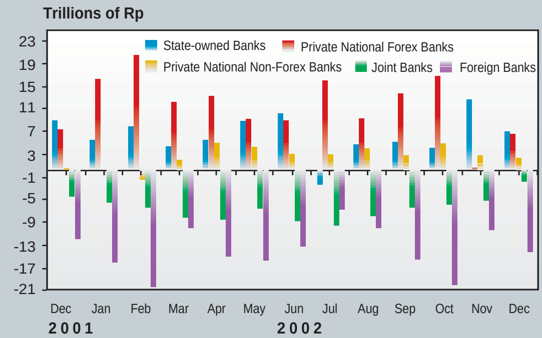
Graph 5.14
Value and Interest Rates in Rupiah Interbank Money Market

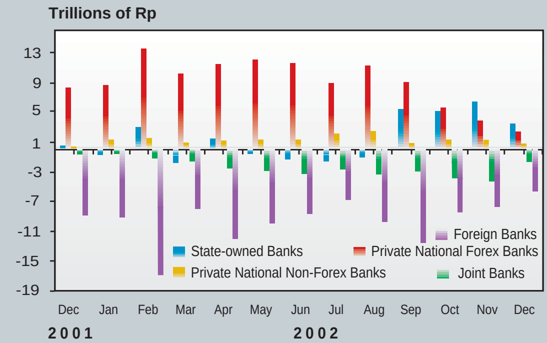
particularly after March. The average daily volume reached $155.5 million, down from $166.7 million in 2001.

Viewed by group of players in the rupiah interbank market, foreign exchange national private commercial banks (BUSD) and non-foreign exchange national private commercial banks (BUSND) remained the dominant lenders in the morning and afternoon sessions (Graph 5.16). The dominance of the BUSD group was due to their highly liquid condition that resulted from large amounts of in-coming funds, particularly from coupons on recap bonds. Meanwhile, foreign banks and joint



Graph 5.15
Foreign Currency Interbank Money Market

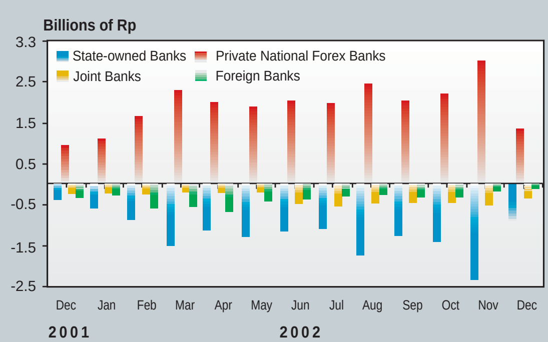




Graph 5.16
Net Lenders and Borrowers in Morning and Afternoon Interbank Money Market

venture banks were consistently net borrowers in both sessions of the interbank money market. As regards the state banks, during 2002 they acted more as net lenders in the morning session, and occasionally acted as net borrowers in the afternoon session, although in relatively small amounts.

Based on groups of players in the foreign currency interbank money market, BUSD was the only group that constantly acted as net lender; other groups acted as net borrowers throughout the year (Graph 5.17). The state bank group remained the major borrower in the foreign exchange market, as



Graph 5.17
Net Lenders and Borrowers in the Foreign Currency Interbank Money Market

they tried to benefit from relatively high rates on offshore placements.

Deposit and Credit Interest Rates

In line with declines in other interest rates, the weighted average interest rates of 1- and 3-month bank deposits fell by 326 bps and 361 bps, respectively, during 2002, to 12.81% and 13.63% at year-end. Despite these declines, the differential between 1-month deposit and 1-month SBI rates narrowed because SBI rates fell more than deposit rates (Table 5.4).

Furthermore, movements in deposit rates were influenced more by changes in the guarantee interest rate, whose decline was not as sharp as that on SBI rates. During the reporting year, the guarantee interest rates on 1- and 3-month deposits declined by only 355 bps and 360 bps to 14.33% and 14.44%. Lower guarantee rates stemmed from declines in average deposits at some JIBOR banks and from a narrowing of the guarantee margin in April and June, by 100 bps each month. With this narrowing, the margin between the average rate at JIBOR banks and the guarantee rate was only 200 bps, compared with 400 bps at the end of 2001.

(Percent)

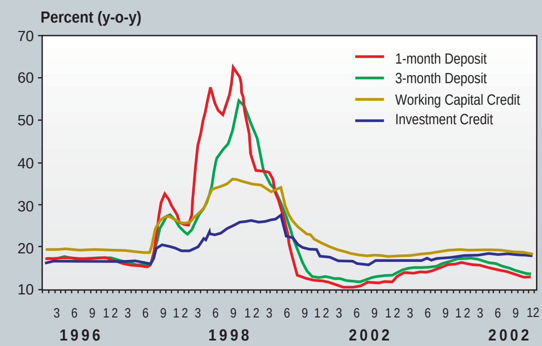
Table 5.4
Development of Interest Rates in 2002[1]

Item	2001 IV	2002 I	2002 II	2002 III	2002 IV	△ 2002
SBI						
1-month	17.62	16.76	15.11	13.22	12.93	-4.69
3-month	17.63	16.89	15.18	14.11	13.12	-4.51
BI Deposit Facility (FASBI)						
O/N	15.13	15.13	14.13	12.63	12.13[2]	-3.00
2-6 days	15.38	15.38	14.38	12.88	12.38	-3.00
7 days	15.88	15.88	14.88	13.13	12.50	-3.38
Interban Money Market (PUAB)						
Puab O/N morning	15.90	15.66	14.54	12.93	12.42	-3.48
Puab O/N afternoon	15.53	15.43	14.47	11.29	8.14	-7.39
Puab O/N currency	1.73	1.66	1.81	1.71	1.25	-0.48
Guaranted Interest Rate						
1-month deposit	17.88	17.87	16.73	15.12	14.33	-3.55
3-month deposit	18.04	18.32	19.92	15.21	14.44	-3.60
PUAB rupiah	15.69	18.15	14.95	13.73	12.72	-2.97
PUAB foreign currency	2.05	1.70	1.67	1.67	1.31	-0.74
Time Deposit						
1-month						
- Counter rate	13.77	13.95	13.62	12.71	11.91	-1.86
- Weighted Average (LBU)	16.07	15.64	14.76	13.50	12.81	-3.26
3-month	17.24	17.02	15.85	14.36	13.63	-3.61
6-month	16.18	16.26	15.73	14.81	13.79	-2.39
12-month	15.48	16.13	16.23	15.99	15.28	-0.20
Credit						
Capital Working	19.19	19.35	19.08	18.74	18.25	-0.94
Investment	17.90	18.03	18.11	18.11	17.82	-0.08
Consumption	19.85	20.11	20.28	20.1	20.21	0.36

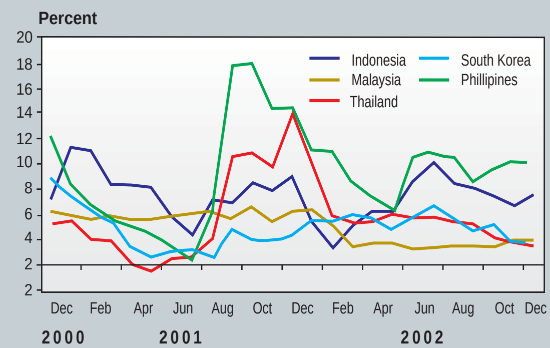
1) Last period
2) Morning session rate

Credit rates did not come down in line with lower deposit rates. During 2002, interest rates on working capital and investment credits dropped by only 94 bps and 8 bps, respectively, to 18.25% and 17.82% at year-end. Rates on consumer credit actually rose by 36 bps and stood at 20.21% in December 2002. However, interest rates on working capital credits, which began to decline in the second quarter of 2002, were below their pre-crisis level of 19.0%. Meanwhile, rates on investment credits, which only decreased a little beginning in October 2002, remain above their pre-crisis level of 16.0% to 16.5% (Graph 5.18). Rigidity in investment credit rates was largely attributable to banks' perceptions of risks that remained high in extending longer term credit, which was reflected in low growth of investment credits. On the demand side, low growth of investment credits also reflected continuing high risks in the business sector.

Nevertheless, demand for bank credit tended to rise, especially for working capital and consumer credit. Higher outstanding working capital credit was consistent with companies' need to utilize available production capacity, supported by modestly lower interest rates. Consumer credit expanded despite higher interest rates, which was affected more by strong demand; relatively low risks faced by the banks in line with low leverage (the ratio of installment



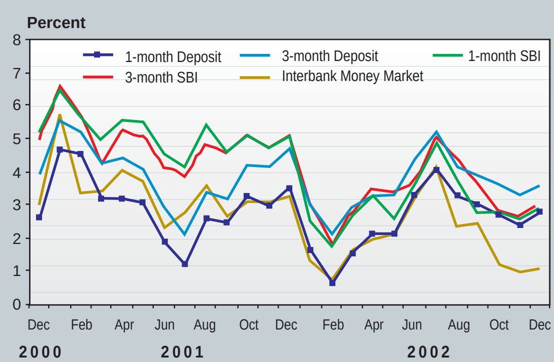
Graph 5.18
Bank Interest Rates



Graph 5.20
Real Deposit Interest Rates of Several Countries

payments against income) of the household sector; and a reorientation of bank credits from the corporate to the retail sector.

At the beginning of the year, several real interest rates (such as SBIs and bank deposits) increased for a while. However, by year-end real interest rates were trending down, as nominal interest rates declined faster than inflation rate. By the end of December 2002, real 1- and 3-month SBIs were down significantly to 2.90% and 3.09%, respectively, from 5.07% and 5.08% at the end of 2001. Real rates on 1- and 3-month deposits also dropped, to 2.78% and 3.60% respectively by the



Graph 5.19
Real Interest Rates

end of the reporting year, compared with 3.52% and 4.69% at the end of 2001 (Graph 5.19).

Despite the downward trend, Indonesia's real interest rates remain higher than those of most other Asian countries, such as Thailand, Korea and Malaysia; with the exceptions of the Philippines (Graph 5.20). Real interest rates in the three countries moved only within the range of 1% to 2%. Therefore, prevailing real deposit interest rates were considered sufficiently competitive to retain public interest to place their funds in the domestic banking sector.

Capital Markets

In light of continuing high bank credit rates, reputable companies turned to the capital market for financing. On the investor side, lower bank deposit rates prompted some investors to shift their funds into bonds and mutual funds, which offered more attractive coupon rates or the prospect of capital gains. In the corporate bond market, a total of 12 companies issued bonds with a total value of Rp5.3 trillion, a rise from 6 companies with a total value of Rp2.9 trillion in 2001. Further in this regard, the number of companies receiving statements of effectiveness to issue bonds reached 100 issuers with a total issuance value of Rp37.2 trillion in 2002. This position rose from 94 companies with a total value of Rp31.7 trillion in 2001. At the end of 2002, the total value of bonds in the secondary market stood at Rp20.6 trillion, roughly unchanged from a year earlier.

Declining bank deposit rates and rising public interest in the bond market increased financial flows into mutual funds, especially those with a fixed return.(Box: Mutual Fund Developments in Indonesia). By product, types of mutual funds issued went up from a total of 108 at the end of 2001 to 131 a year later. The number of participating units jumped from a total of 51,723 units at the end of 2001 to 125.820 units. Net Asset Value (NAB) soared from Rp8.0 trillion at the end of 2001 to Rp46.61 trillion at end-2002.

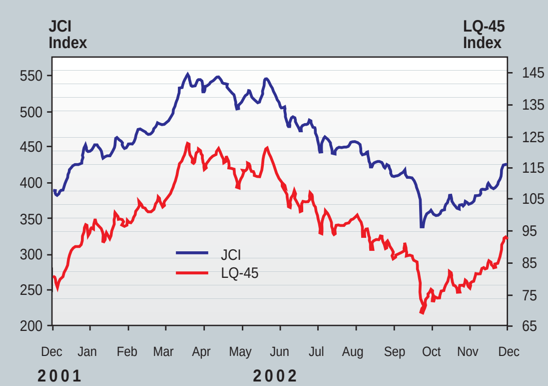
Continuing high credit rates in the banking sector encouraged businesses to raise funds on the stock market, as evidenced by rising numbers of IPOs and right issues. A total of 20 companies made IPOs during 2002 with a total value of Rp1.2 trillion in 2002. This compares with Rp1.1 trillion raised by 32 companies in 2001. Total right issues raised Rp8.7 trillion (by 12 companies) in 2002 versus Rp4.2 trillion (by 13 companies) in 2001.

During 2002, performance of the local stock market was driven more by sentiment-related factors and developments abroad than, for example, domestic interest rate movements. In line with the firmer exchange rate and relatively stable domestic political and security conditions, the stock market improved during the first 4 months of 2002 before deteriorating through end-October. It closed the year on a minor up-tick. During the first 4 months, the composite index rose fairly steadily through April, reaching a peak of 551.07, the best since May 2000 (Graph 5.21).

Improving stock market conditions early in the year were driven by external and internal factors. Looking at external factors, improved expectations as regards the global economy pushed up the indexes of several international bourses, which influenced the performance of domestic stock trading. The Dow Jones and Nikkei indexes reached as high as 10,635 and 11,980, respectively (Graph 5.22). Internal factors that boosted the stock market, included:

1. The firmer exchange rate and relatively stable domestic political and security conditions.
2. Government success in rescheduling foreign debts in the Paris Club forum, followed by debt rescheduling through the London Club. And,
3. Successful divestment of 51% of government shares in BCA, which created some optimism towards the domestic investment climate.

The composite index and LQ 45 index (which measures the performance of the 45 most liquid shares on the Jakarta Stock Exchange) peaked at 551.07 and



Graph 5.21
Developments of Composite Index and LQ 45 Index

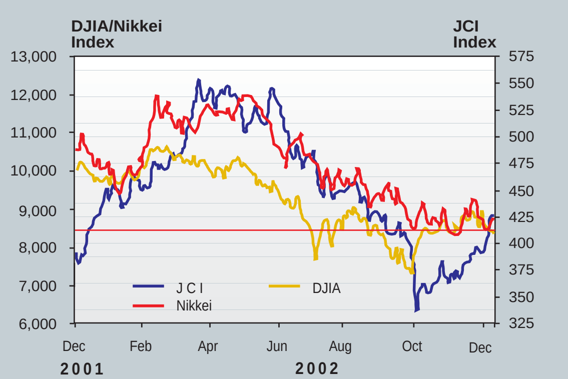
122.09, respectively, compared with their end-2001 values of only 392.03 and 80.06.

However, in line with deteriorating regional and international bourses (mainly due to financial scandals concerning major US companies), the composite index of the Jakarta Stock Exchange also weakened. This weakening was magnified by several domestic events. These factors included: the decision on the bankruptcy of PT Asuransi Manulife Indonesia; postponement of the Bank Niaga divestment; and unsatisfactory achievement in the divestment of government shares in Indosat. Performance of the domestic stock market was further weakened by the Bali tragedy in mid-October, which caused the composite and LQ 45 indexes to fall to 337.475 and 69.09, respectively, their lowest levels since 1999. The composite and LQ 45 indexes closed 2002 at somewhat better positions, of 424.945 and 91.98, respectively.

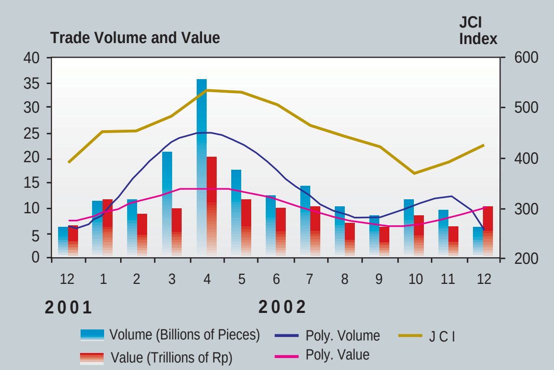
Other capital market performance indicators (such as shares traded by value and volume, market capitalization, and net foreign buying) moved in tandem with the indexes. The volume of shares traded peaked at 35.72 billion shares (with a value of Rp20.3 trillion) in April, before dropping to 6.29 billion shares (with a value of Rp10.2 trillion) in December 2002. However, this value was still higher than the Rp6.6 trillion at the end of 2001 (Graph 5.23).

Market capitalization reached its highest value of Rp344 trillion (with 889.9 billion shares) in April, when it started on a downward trend, falling to Rp268.8 trillion (with 939.5 billion shares) at the end of 2002. This was still substantially above the end of 2001 when capitalization stood at Rp239.3 trillion (884.2 billion shares).

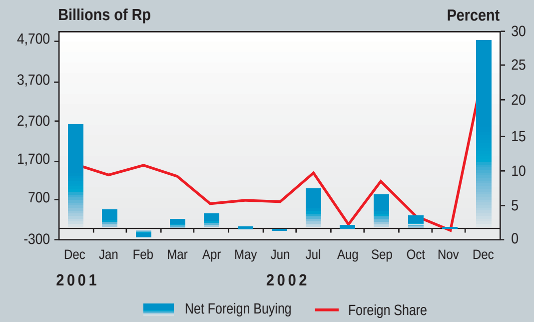
Net foreign buying peaked at Rp1.0 trillion in July 2002 (Graph 5.24). After that it trended downwards and in November there was net foreign selling of Rp17.1 billion. After that, net foreign buying rebounded sharply, to Rp4.8 trillion by year-end, due in part to a successful divestment process, which also improved prices for some blue chips. In line with these developments, the percentage of foreign trading value in total trading during 2002 trended downward after July, before recovering somewhat and reaching 24.0% at year-end (Graph 5,24).



Graph 5.22
Stock Index Movements at Several Bourses



Graph 5.23
Trade Value and Volume



Graph 5.24
Net Foreign Buying/Selling

Government Bonds

Declines in interest rates on monetary instruments and at banks during 2002 changed the composition of government bonds and trading volumes in the secondary market as follows:

1. The number of variable rate (VR) bonds increased because they replaced other types of maturing bonds.
2. Rising demand for government bonds in the secondary market by non-bank groups.
3. Increasing trading of fixed rate (FR) bonds in the secondary market.
4. Generally declining bond yields, particularly the FR series, which raised the price of FR-series bonds.

Since the beginning of government bond issuance on May 28, 1999 through October 31, 2000, total bonds issued reached Rp430.4 trillion. By the end of 2002, it was down to Rp419.4 trillion compared with Rp435.3 trillion at the end of 2001 (Table 5.5). Viewed by composition, at the end of 2002 the bonds mainly comprised VR bonds (Rp239.6 trillion or 57.1% of the total), followed by FR bonds of Rp154.5 trillion (36.8%), and hedge bonds (HB) amounting to Rp25.3 trillion (6.0%). Relative to end-2001, outstanding amounts of FR and HB bonds declined, while the position of VR bonds tended to rise; the downward trend of interest rates encouraged the government to replace several maturing FR and HB bonds with VR bonds.

The decline and change in bond composition during 2002 were, among others, caused by:

1. The replacement of FR bonds owned by several banks (a total of Rp24.8 trillion) with VR bonds in March 2002. This was in conjunction with the continuous decline of 3-month SBI interest rates throughout 2002.
2. Cash redemption of the VR0001-series bonds that had matured in July 2002, in the amount of Rp3.9 trillion.
3. Redemption of Rp7.2 trillion VR bonds and Rp1.5 trillion FR through the asset-to-bond swap program from August to December 2002. This program covers the exchange of government bonds for restructured credits or straight bonds (that is ones with no equity element) at IBRA. The aim is to reduce the debt servicing (interest and principal at maturity) burden of payment obligations on government bonds.
4. The exchange of maturing HB bonds in the amount of Rp10 trillion for VR bonds (Rp 6.5 trillion) and FR bonds (Rp3.5. trillion) with maturities from 2008 till 2011.
5. Indexing of HB bonds, which were adjusted in line with the strengthening of the exchange rate throughout 2002.
6. In addition, in November 2002, the government undertook reprofiling of government bonds owned

(Billions of Rp)

Table 5.5
Development of Position of Government Bonds

Items	Total Recap Bonds*	Shares (%)	2001	Shares (%)	2002	Shares (%)
Based on Type	**430,422**	**100.00**	**435,303**	**100.00**	**419,356**	**100.00**
Fixed Rate	167,217	38.85	175,464	40.31	154,456	36.83
Variable Rate	226,398	52.60	219,479	50.42	239,602	57.14
Hedge Bond	36,807	8.55	40,360	9.27	25,299	6.03
Based on Portfolio	**430,422**	**100.00**	**435,303**	**100.00**	**419,356**	**100.00**
Investment	430,422	100.00	370,649	85.15	319,643	76.22
Tradeable	-		64,654	14.85	99,713	23.78
- Available for Trade			61,184	94.6	99,713	100.0
- Collateralized			3,470	5.4		0.0
Based on Ownership	**430,422**	**100.00**	**435,303**	100.00	**419,356**	100.00
Ministry of Finance	430,422	100.00	878	0.20	872,5	0.21
Recap Banks			396,631	91.12	359,872	85.82
Non-Recap Banks			24,773	5.69	13,829	3.30
Sub-Registry			13,022	2.99	44,782	10.68

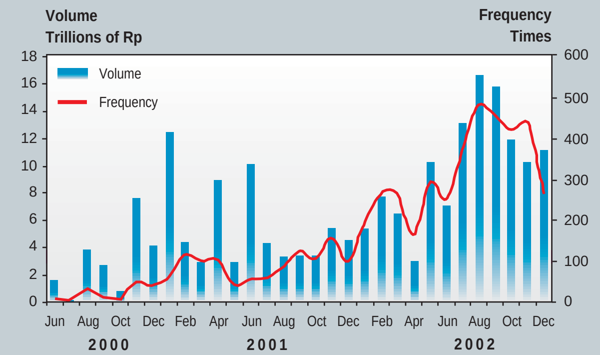
* Total bank recap bonds since May 28, 1999 to October 31, 2000

by 4 recapitalized state-owned banks, in the amount of Rp171.8 trillion. This program was undertaken through the exchange of bonds due to mature between 2004-2009 for a new series of longer-term bonds with maturity between 2010-2020 (Box : Reprofiling of Government Bonds).

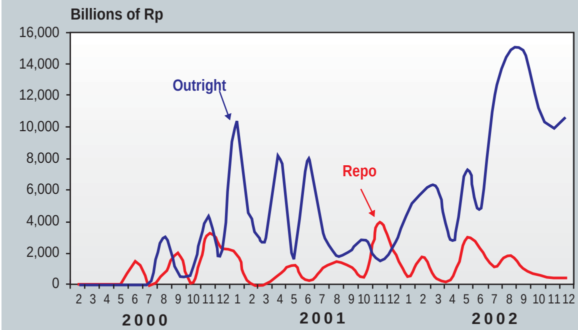
In the secondary market, bond trading portfolios increased significantly, consistent with the higher allowable percentage of tradable government bonds, from 25% to 100% of total portfolios owned. Total portfolio trading rose from Rp64.7 trillion (14.9% of total bonds) in 2001 to Rp99.7 trillion (23.6%) in December 2002. The rise in portfolio trading also reflected continuing high demand for liquidity by recapitalized banks; rising market demand for government bonds; and a need for funds to repay some recapitalized banks' obligations to IBRA.

Bond trading in the secondary market was on a sharp upward trend throughout 2002, reaching an average daily value of Rp475.2 billion, far higher than the Rp256.5 billion per day in the year before. Trading in the secondary market reached its peak in August 2002 at an average daily value of Rp754.7 billion (Graph 5.25). Types of bond transactions in the secondary market can be differentiated as between repurchase transactions (selling with the obligation to repurchase) and outright transactions (selling only, with no further obligation). Of these transactions, outright transactions dominated (Graph 5.26). As regards outright transactions, FR bonds were more sought after by investors than were VR bonds, which stood in contrast to 2001, and was due to the downward trend of 3-month SBI interest rates during 2002.

Viewed by the composition of ownership after-transaction in the secondary market, the largest holders of recap bonds were still the recapitalized banks with a total value of Rp359.9 trillion or 85.8% of total bonds (Graph 5.27). This was followed by the sub-registry



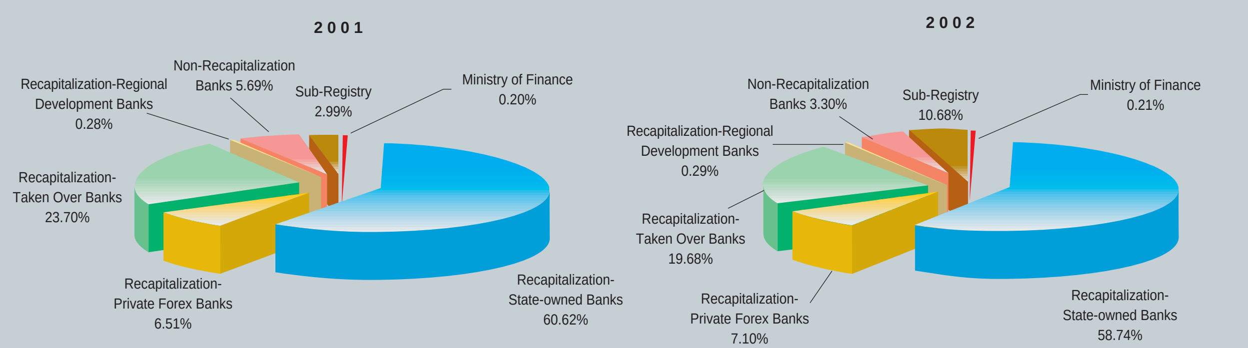
Graph 5.25
Development of Volume and Frequency of Government Bond Trade Transactions



Graph 5.26
Development of Volume of Bond Trade Transactions By Type of Transactions

group, which comprises several non-bank financial institutions and the public, amounting to Rp44.8 trillion (10.7%). Ownership by this group was up from only Rp13.02 trillion (3.0% of the total) in 2001. This rise was triggered by the downward trend of deposit interest rates and less attractive capital market conditions throughout 2002. Bonds owned by non-recapitalized banks reached Rp13.8 trillion (3.3%), far lower than Rp24.8 trillion at the end of 2001. Meanwhile, foreign ownership of government bonds in 2002 remained very small with a share of around 0.14%. However, the value rose from Rp38.0 billion in 2001 to Rp611.12 billion in 2002.

During the review period, trading in government bonds was mainly influenced by the declines in SBI interest rates and by the reprofiling exercise. Both factors pushed down yields, especially for shorter-term and FR bonds. The reprofiling issue created positive sentiment in the market, because the spread of bond maturities over a longer timer period increased the market's confidence in the government's capacity to repay.



Graph 5.27
Ownership of Government Bonds

box

DEVELOPMENT OF REKSA DANA (MUTUAL FUNDS) IN INDONESIA

Investments in the form of reksa dana (mutual funds) were first introduced in Indonesia in 1996, covering investment placements in fixed income mutual funds, equity mutual funds, mixed mutual funds and money market mutual funds. As of December 2002, there were 131 types of mutual funds marketed by various financial institutions in Indonesia. The development of reksa dana began to mushroom in 2002, when around 60% of reksa dana was marketed through banks. Recently, 12 banks have become sales agents for reksa dana, consisting of 6 foreign banks and 6 private national banks and joint banks. For their services, banks obtain certain fee income from fund managers. By October 2002, banks acting as mutual fund agents had mobilized public funds of around Rp27 trillion, which is around 60% of total funds mobilized by mutual funds.

(Trillions of Rp)

Public Funds Managed by Fund Managers in 1995-2002

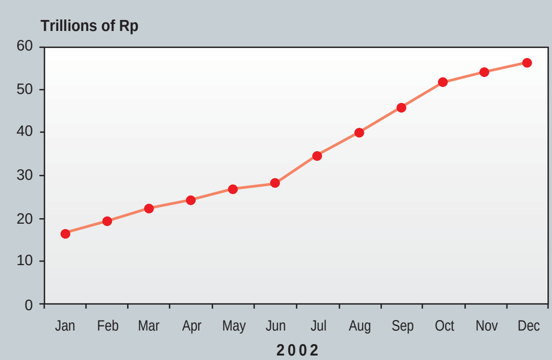
Year	Public Funds
1995	2.58
1996	5.20
1997	8.75
1998	5.39
1999	9.05
2000	10.25
2001	15.88
2002	56.09

Source : Capital Market Statistics, Bapepam

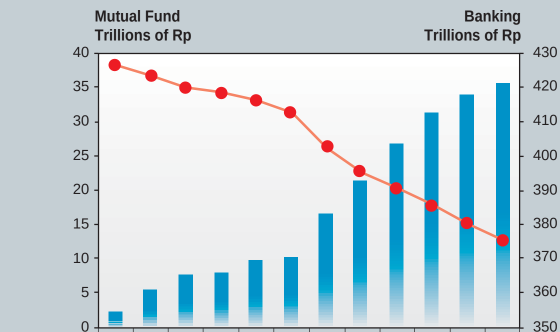
Most reksa dana are in the form of fixed income mutual funds with rates of return ranging from 10% to 14%; the average is around 12%-13% annually. One fixed income mutual fund has a rate of return of 18.94% annually, and there were once 3 other types of mutual funds with annual rates of return of 40%.

In January 2002, mutual funds amounted to Rp16.62 trillion and they rose to Rp56.09 trillion at the end of December 2002, which is an increase of 237.5%. The increase was particularly rapid during the final quarter of 2002. Net Asset Value (NAV) of reksa dana increased from Rp8.53 trillion in January 2002 to Rp46.61 trillion at December 2002. Of this, fixed income mutual funds accounted for the bulk, namely Rp37.4 trillion or 80.1% of the total NAV of mutual funds. The largest component of the fixed income reksa dana is government bonds, which is relatively low risk.

The rapid growth of mutual funds during past year was due to several factors. From the customers'



Public Funds Mobilized by Reksa Dana



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Mutual Fund	2.3	5.4	7.6	8.0	9.8	10.1	16.5	21.4	26.8	31.2	33.87	35.7
Banking	426.2	422.9	419.7	418.2	415.9	412.5	402.2	395.3	390.3	385.6	380.2	375.6

Ownership of Government Bonds by Reksa Dana and Banking 2002

side, these include: (i)the downward trend in SBI rates, followed by declining deposit rates, (ii) mutual funds with maturity less than 5 years are exempted from coupon and capital gains tax according to the Tax Law No. 17/2000, And (iii) since August 2002, fund managers are allowed to invest maximum 15% of total mobilized funds in foreign securities.

From the banking side, those factors include: (i) when good credits are scarce, banks can improve their asset structure, liquidity and income by trading in government bonds, (ii) a shift of public funds from time to demand deposits owned by fund managers, would reduce a bank's cost of funds.

Rapid development of mutual funds is expected to continue because the ratio of reksa dana to total public savings has reached just 6.3%. By comparison, the ratio of public savings to total bank deposits is 93.7%, of which 53.4% was in the form of time deposits. This ratio is far below Malaysia and the US where the ratios of mutual funds to total public funds are around 50% and 60%, respectively. Despite its high return, the mutual fund investment also contain some risks.

The risks of mutual funds investment for customers include:

- Credit risk: a drop of NAV if the fund manager and/or the issuer were to default.
- Liquidity risk: risk of delayed payment if there were to be a public rush to redeem their mutual funds in a short period of time. And,
- Price risk: the NAV will decline if the underlying asset prices fall.

For banks acting as mutual funds agents, there is a possibility that banks could be sued by their customers due to a misunderstanding on the part of customers (reputation risk). For example, when buying the mutual funds, the customer might think that the mutual fund is covered under the deposit guarantee program.

The rapid increase in mutual funds needs to be accompanied by prudent monitoring and supervision by Bapepam of the issuing institutions. By way of examples, to protect customers' interests through sound regulations:

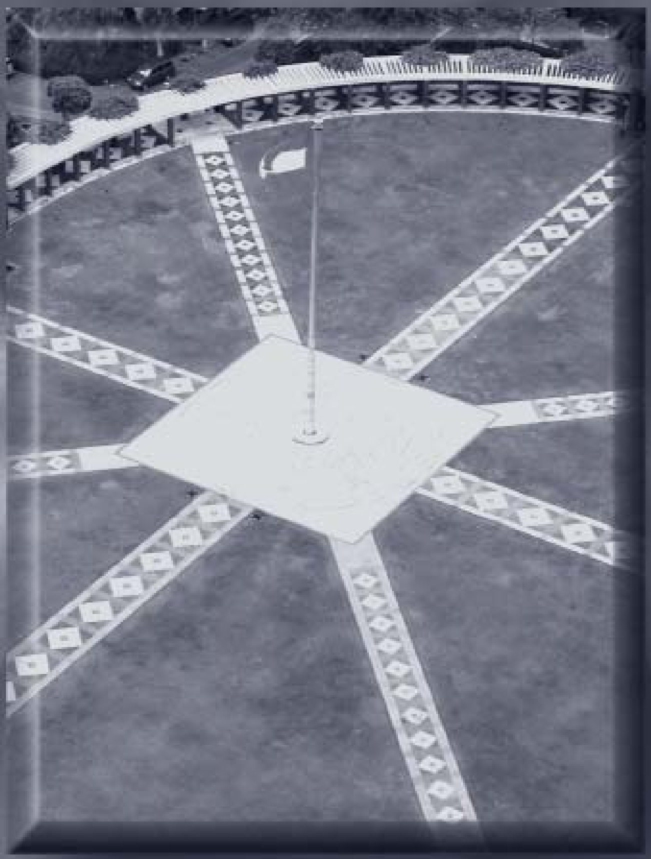
(i) The custodian agent should be a bank.

(ii) The mutual fund portfolio owned by fund manager must comprise only rated securities that are listed on the stock exchange. And,

(iii) Regulation of exposure on securities' purchases by fund manager. For instance, a limit on mutual fund holdings of the securities of one company or a business group.

CHAPTER 6
Annual Report

Balance of Payments



CHAPTER

6 BALANCE OF PAYMENTS

The improvement of the Indonesia's balance of payments was mainly supported by a declining capital account decifit resulting from foreign debt restructuring and an increasing current account surplus

During the reporting year, the overall balance of payments improved from the year before. This was reflected in a widening of the current account surplus and a narrowing of the deficit on capital account. The source of current account surplus came from exports that increased more rapidly than imports. The export performance was especially encouraging because export had declined sharply in 2001. On capital account, successful rescheduling of offshore loans by both the goverment and private sector contribute to smaller deficit in government and private net capital flows.

Although exports improved in 2002, they still faced several problems coming from external and internal sources. Externally, global economic conditions remained sluggish, particularly in several advanced countries that are Indonesia's major export markets. In addition, Indonesia's exports continue to face several problems related to heightened global competition and tighter quality standards imposed on several commodities by trading partners. Internally, exports in 2002 were hindered by various structural problems, such as labor and law enforcement problems, security conditions, and ongoing low investment. This was reflected in a drop in non-oil/gas imports, especially raw materials and capital goods, which are mostly used by industries that produce exports.

On the capital account side, the narrower deficit on private capital flows was the result of privatisation and divestment, rescheduling of private debts, issuance of several corporations' bonds abroad and larger loan drawdowns by foreign investment companies. For its part, the narrower deficit on government capital flows mainly stemmed from declining payments on offshore debts due to successful rescheduling of government foreign debts and from larger disbursements of IMF loans.

On the basis of these developments, Indonesia's overall balance of payments shifted to a surplus of $3.6 billion in 2002 from a deficit of $1.4 billion in 2001. Reflecting this surplus, official foreign exchange reserves at the end of 2002 stood at $31.6 billion (Table 6.1).

Various government policies contributed to these encouraging balance of payments developments. In the areas of exports and imports, the government established the Coordinating Team for Increasing Smooth Flows of Export and Import Goods.[1] The task of the coordinating team is to formulate integrated and coordinated policy measures to facilitate smooth flows of international trade and to increase Indonesia's export competitiveness. Also, within the framework of

1 Presidential Decree No. 54, 2002 dated July 23, 2002 concerning Coordinating Team for Increasing Smooth Flows of Export and Import Goods

(Billions of $)

Table 6.1
Indonesia's Balance of Payments

Item	2000	2001	2002*
A. Current Account	**8.0**	**6.9**	**7.3**
1. Merchandise	**25.0**	**22.7**	**23.1**
a. Export f.o.b	65.4	57.4	58.0
Non-oil/gas	50.3	44.8	45.3
Oil/gas	15.1	12.6	12.7
Oil	8.0	6.9	6.7
LNG	6.8	5.3	5.7
LPG	0.4	0.4	0.3
b. Impor (fob)	-40.4	-34.7	-34.8
Non-oil/gas	-34.4	-29.0	-28.3
Oil/gas	-6.0	-5.7	-6.6
Oil	-5.8	-5.4	-6.3
Gas	-0.1	-0.3	-0.3
2. Services	**-17.1**	**-15.8**	**-15.9**
a. Non-oil/gas	-12.5	-11.5	-11.6
b. Oil/gas	-4.6	-4.3	-4.2
Oil	-2.2	-2.4	-2.1
Gas	-2.4	-1.9	-2.1
B. Capital Account	**-6.8**	**-9.0**	**-3.6**
1. Oficial capital movements (net)	**3.2**	**-0.7**	**-0.6**
a. Inflows	5.0	1.1	1.3
b. Debt repayments 1)	-1.8	-1.8	-1.8
2. Private capital movements (net)	**-10.0**	**-8.3**	**-3.0**
a. Direct investment (net)	-4.6	-5.9	-6.9
b. Others (net)	-5.4	-2.4	3.9
C. Total (A+B)	**1.2**	**-2.1**	**3.7**
D. Net Errors and Omissions	**3.8**	**0.7**	**-0.1**
E. Monetary Movement 2)	**-5.0**	**1.4**	**-3.6**
Notes:			
1. Gross Foreign Assets (GFA) 3)	**29.4**	**28.0**	**31.6**
equivalent to non-oil and gas imports and official foreign debt repayments (months)	**6.0**	**5.9**	**6.6**
2. Current account/GDP (%)	**3.4**	**4.7**	**3.9**

1) Taking into account the rescheduling & payments to IMF
2) Minus (–) = Surplus, vice versa
3) Since 2000, based on IRFCL concept, replacing GFA concept

increasing the value added of mining exports and preserving the environment, the government re-examined export goods that are regulated, supervised, and prohibited.[2] In order to boost manufacturing activities, the government issued a regulation on import procedures for used machinery and complementary equipment.[3] This regulation established the criteria for used machinery and equipment that can be imported and provided stipulations concerning tests of worthiness for those imports. In accordance with various government policies to drive exports and imports, Bank Indonesia relentlessly tries to intensify the effectiveness of Monitoring of Foreign Exchange Flows. While formerly only banks are required to report their capital movement activities, since 2002 non-financial institution companies are also obliged to report theirs. (Box : Monitoring Foreign Exchange Flows of Non-Financial Institution Corporations)

In a strong bid to reduce capital outflows, the government rescheduled its foreign debts through two phases of the Paris Club (PC II and PC III) and the London Club. Unlike previous rescheduling that only covered loan principal, PC III also covered rescheduling of interest payments. In addition, and in line with comparable treatment resulting from PC III, the government negotiated with the London Club to re-schedule its foreign commercial debts, covering both principal and interest on syndicated loans.

Efforts to reduce private capital outflows through rescheduling of private bank and non-bank offshore debts were also more successful in 2002 than 2001. Settlement of private offshore debts under the Jakarta Initiative Task Force (JITF) reached some 65.2% of total offshore debts assigned to JITF, up 14% from the previous year. Rescheduling of private bank offshore debts through the Exchange Offer I and II programs also moved ahead at a good pace.

2 Decree of the Minister of Industry and Trade No. 575/MPP/KEP/VIII/2002 concerning the Amandment to Attachment to Decree of the Minister of Industry and Trade No. 558/MPP/KEP/12/1998 concerning General Regulations after several revision with the Decree of the Minister of Industry and Trade No. 443/MPP/KEP/5/2002, dated August 6, 2002

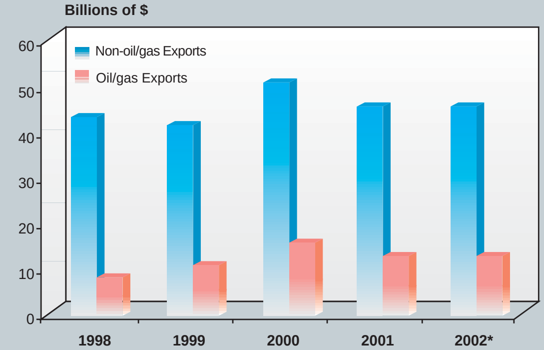
3 Decree of the Minister of Industry and Trade No. 756/MPP/II/2002 concerning Imports on Used Machinery and Complementary Equipment

CURRENT ACCOUNT

During 2002, the current account recorded a surplus of $7.3 billion, up from $6.9 billion in the previous year (Table 6.1 and Graph 6.1). This rise in the current account surplus mainly originated in the trade account, which was in a surplus of $23.1 billion. Furthermore, the improved trade account stemmed from higher exports (both oil/gas and non-oil/gas) and a decline in non-oil/gas imports, although oil and gas imports rose appreciably. The decline in non-oil/gas imports largely occurred in raw materials and capital goods, reflecting continuing weak domestic investment and production. For its part, the services account recorded a deficit of $15.9 billion in 2002, relatively unchanged from last year's $15.8 billion. This stemmed from the decline in the services deficit on oil/gas sector account that was almost matched a rise in the deficit on non-oil/gas services.

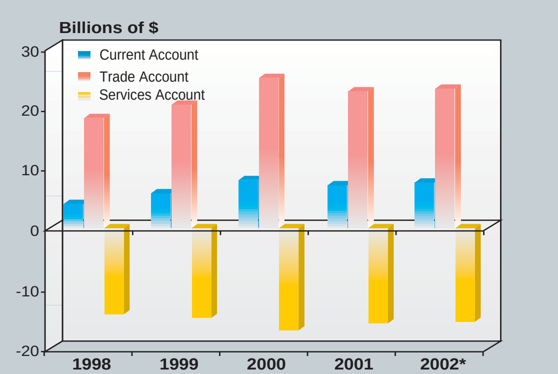
Exports

Indonesia's export performance during the reporting year improved relative to the previous year. Total exports reached $58.0 billion, up from $57.4 billion last year. Non-oil/gas exports amounted to $45.3 billion, whereas oil and gas exports reached $12.7 billion (Graph 6.2).

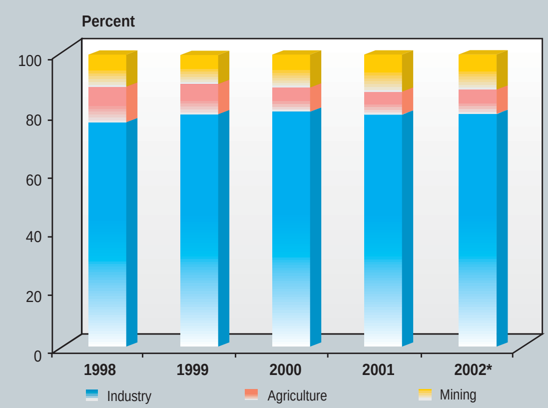


Graph 6.2
Non-Oil/Gas and Oil/Gas Export Values

During the reporting year, non-oil/gas exports increased by 1.0%, compared with a decline of 11.0% the year before. By sector, this increase stemmed from the agricultural and industrial sectors, which grew by 10.2% and 0.9%, respectively. Exports from mining sector declined by 4.4%. As was the case last year, the structure of non-oil/gas exports was still dominated by industrial sectors, which accounted for 79.5% of total non-oil/gas export values. Mining and agriculture had shares of 11.9%



Graph 6.1
Current Account, Trade Account and Services Account



Graph 6.3
Share of Non-Oil/Gas Exports

and 8.7%, respectively (Graph 6.3). Compared with the previous year, industry's share of exports is relatively unchanged; the share of mining dropped from 12.5%, while agriculture's share sector rose from 7.9%.

In the agricultural sector, export values reached $3.9 billion, up from $3.6 billion the year before. Rising exports occurred in several main commodities, such as raw rubber (19.0%) and coffee (36.7%). The increase of raw rubber exports was largely due to the agreement of the International Tripartite Rubber Company (ITRCo) between Indonesia, Malaysia, and Thailand signed on August 2002. This agreement was, among others, for the purpose of monitoring a production reduction scheme (management scheme). The agreement by these three major rubber-producing countries was able to lift international rubber prices. Also, the entry of Vietnam into the membership of the Asean Rubber Business Club (ARBC) pushed up natural rubber prices, considering that ARBC now accounts for almost 90% of the world rubber market. The rise in exports of coffee was mainly due to higher volumes to meet rising world demand.

By contrast, exports of shrimps, as a major agricultural product, fell by 10.6%. This decline was partly due to price drops in the international market related to a health issue such as some shrimps originating from Asia contained quite high levels of chloramphenicol. This dampened consumers' interest due to worries that these products were not safe for consumption. In addition, a worker strike on the US west coast hampered exports of goods, including shrimps, to that country.

In the industrial sector, the value of total exports reached $36.0 billion, which is up 0.9% from the year before (Table 6.2). Exports increased in several main commodities, such as palm oil (54.0%) and electronic goods (7.3%). The rise in palm oil exports was attributable to rising world demand in the face of production declines in several competitor countries. In addition, production declines in competing vegetable oils (particularly soybean and sunflower oil) boosted export volumes and prices of palm oil in the international market. The rise in exports of electronic goods stemmed from global development of information technology (IT); IT components dominate the export structure of electronic goods from Indonesia.

In the meantime, exports of primary commodities such as textiles and textile products declined sharply (-9.4%) in 2002, after a similar decline in the previous year (-7.7%). This decline was prompted by, among others, the relocation of textile factories to China and Vietnam, due to the less conducive Indonesian business

Table 6.2
Industrial Goods Exports

Item	2001	2002*	2002*	
	Growth (%)		Value (millions of $)	Share (%)
Textile & textile products	-7.7	-9.4	6,116	13.5
– Garments	-6.0	-14.8	3,256	7.2
Handicrafts	-2.9	-5.9	501	1.1
Wood and wood products	-11.9	-4.5	3,783	8.4
– Plywood	-13.6	-12.2	1,515	3.3
Rattan products	-8.1	3.3	280	0.6
Palm oil	6.2	54.0	2,068	4.6
Copra oil-cake	-20.3	30.8	64	0.1
Chemical products	-5.0	4.5	2,242	5.0
Metal products	-7.1	-7.7	1,043	2.3
Electrical appliances	-3.9	7.3	6,562	14.5
Cement	20.7	-33.1	113	0.3
Paper	-12.1	-6.6	2,500	5.5
Rubber product	-2.3	21.0	520	1.1
Glass and glassware	-12.5	1.2	309	0.7
Footwear	-11.6	-5.8	1,349	3.0
Plastics products	-15.8	2.8	1,053	2.3
Machinery and Mechanical	-19.3	2.4	3,128	6.9
Others	-31.8	2.2	4,329	9.6
Total	**-12.3**	**0.9**	**35,962**	**79.5**

Table 6.3
Exports of Mining Products

Item	2001	2002*	2002*	
	Growth (%)		Value (Million of $)	Share (%)
Tin	4.8	16.8	287	0.6
Copper	6.3	-8.0	2,224	4.9
Nickel	-16.9	-84.4	47	0.1
Aluminum	-18.6	10.1	233	0.5
Coal	19.0	10.2	2,144	4.7
Others	-37.5	-13.3	436	1.0
Total	**1.0**	**-4.4**	**5,370**	**11.9**

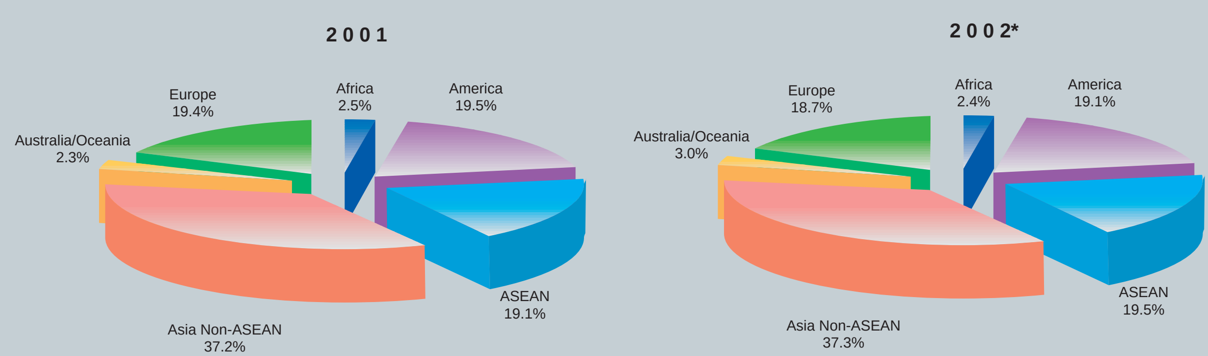
climate related to unresolved domestic structural problems.

In the mining sector, exports amounted to $5.4 billion, a drop of 4.4% from the year before. There was a drop in exports of several commodities, such as copper (-8.0%) and nickel (-84.4%), attributed to falling prices in the international market. Nonetheless, the export value of aluminum, coal and tin rose by 10.1%, 10.2%, and 16.8%, respectively (Table 6.3).

Based on export destination, the shares of non-oil/gas exports to countries in Asia reached 56.8%, the American region 19.1%, Europe 18.7%, Australia/Oceania 3.0%, and Africa 2.4% (Graph 6.4). The largest non-oil/gas export destination in the Asian region was ASEAN, followed by Japan and China. On a country basis, the shares of Indonesia's exports to the US and Japan dropped by 1.3% and 9.8%, respectively, relative to last year. The drop in the share to the US stemmed from, among others, rising exports from competitor countries, such as China and Vietnam.[4] Meanwhile, the share of Indonesia's exports to Australia/Oceania and Singapore increased to 32.6% and 1.3%, respectively.

Amidst rising world oil prices, oil and gas exports increased by 1.3%. Viewed by component, this rise originated in a rise in gas exports of 7.1%; crude oil exports dropped by 3.5%. This decline in crude oil exports was attributable in part to declining domestic oil production, from 1.3 to 1.2 million barrels per day. Lower oil production is largely due to a natural decline in production at several existing wells; in-progress implementation of new technology; minor discoveries of new oil reserves relative to drop-offs in production at existing oil fields. Meanwhile, the average price of

4 US import of goods from China and Vietnam, as of QI-2002, rose by 12.35% and 0.05%, respectively. Source: Bulletin of Indonesian Economic Studies (BIES). Vol. 38. No. 2, 2002: 141-162



Graph 6.4
Non-Oil/Gas Import Share By Originating Region

crude oil exports in 2002 rose to $24.6 barrel from $23.4 per barrel in 2001. The rise in oil prices was partly prompted by the possibility of an attack by the US on Iraq and the disruption in Venezuela, a major oil exporter. On the other hand, the average export price of liquefied natural gas (LNG) and liquefied petroleum gas (LPG) dropped to $4.2 per MMBTU and $249.1 per thousand MTon from $4.3 per MMBTU and $258.4 per thousand MTon, respectively.

Imports

In line with rising exports, import edged up by 0.5% in 2002 to $34.8 billion. This was accounted for by rising oil and gas imports, to $6.6 billion from $5.7 billion in 2001. On the other hand, non-oil/gas imports declined, from $29.0 billion to $28.3 billion in the reporting year.

By category of goods, the decline in non-oil/gas import value occurred in raw materials and capital goods. These dropped by 2.9% and 6.7%, respectively while imports of consumer goods rose by 12.7% (Table 6.4). These developments reflected continuing low investment and production activities in Indonesia. Meanwhile, the rise in oil and gas imports was largely accounted for by oil, which jumped by 16.4%; gas was little changed from the previous year. As was the case in the previous year, non-oil/gas imports in 2002 were dominated by raw materials category, followed by capital and consumer goods. Compared with last year, the shares of raw materials and capital goods declined slightly, while that of consumer goods rose.

Within the raw materials and capital goods categories, imports of almost all goods declined, particularly semi-processed raw materials for industry (in the raw materials category) and mechanical machinery (in the capital goods category) (Tables 6.5 and 6.6). Declines in these two industry-supporting sub-categories showed that there had been a decline in additions to machinery, due in part to continuing weak domestic investment. Meanwhile, in the consumer goods category, the rise was mainly accounted for by food and beverages, non-industrial transportation equipment, and semi-durable goods.

Viewed by country of origin, the shares of non-oil/gas imports (cif) from countries in Asia reached 59.0%, Europe 18.5%, American region 14.3%, Australia/ Oceania 7.0% and Africa 1.3% (Graph 6.5). The largest

Table 6.4
Non-Oil/Gas Imports By Goods Category

Item	Value (Million of $)		Growth (%)		Share (%)	
	2001	2002*	2001	2002*	2001	2002*
Consumption goods	2,287	2,576	-5.8	12.7	7.9	9.1
Raw material goods	20,886	20,281	-15.7	-2.9	72.1	71.8
Capital goods	5,789	5,402	-19.2	-6.7	20.0	19.1

Table 6.5
Imports of Raw Materials

Item	2001	2002*	2002*	
	Growth (%)		Value (Millions of $)	Share (%)
Food and beverages mainly for industry	-16.0	14.1	1,090	3.9
Processed food and beverages	-14.1	-7.7	723	2.6
Primary raw materials	-21.0	-0.5	2,576	9.1
Processed raw materials	-14.2	-5.6	12,363	43.8
Primary fuel and lubricants	-23.5	-1.5	12	0.0
Proccessed fuel and lubricants	10.5	-6.9	139	0.5
Spare parts and accessories for capital goods	0.4	-5.2	1,648	5.8
Spare parts and accessories for transportation equip't	-32.5	10.6	1,728	6.1
Total	**-15.7**	**-2.9**	**20,281**	**71.8**

Table 6.6
Imports of Capital Goods

Item	2001	2002*	2002*	
	Growth (%)		Value (Million of $)	Share (%)
Tractors & agriculture equipments	-49.6	51.8	34	0.1
Handicraft and accessories	-16.8	-22.3	0	0.0
Container & storage box	23.1	3.2	61	0.2
Nuclear Reactor dan Machinery	-7.8	-12.1	3,225	11.4
Generator & electronics	-2.4	12.1	714	2.5
Locomotive, ship, & aircraft	-44.2	-2.4	910	3.2
Craftsmanship tools	-1.7	-2.8	39	0.1
Optical & measurement devices	-41.1	-7.3	326	1.2
Passenger cars	-39.3	22.7	93	0.3
Total	**-19.2**	**-6.7**	**5,402**	**19.1**

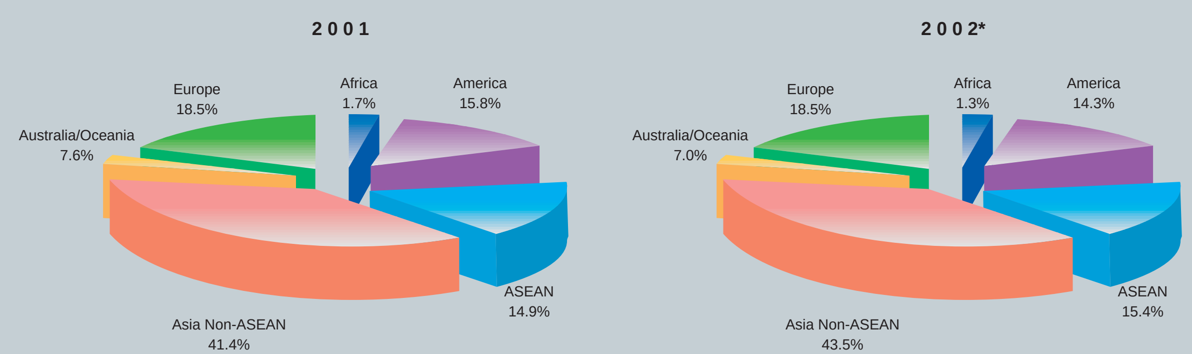
non-oil/gas exporter to Indonesia from Asia was Japan, followed by ASEAN and China. On a country basis, import shares from Japan and China in 2002 experienced rises relative to the year before, from 16.9% and 6.7% to 18.1% and 8.6%, respectively. Meanwhile, the share from America was 14.3%, down from 15.8% the year before.

Services

As in previous years, the services account was in deficit in 2002 in the amount of $15.9 billion. This was contributed by deficits in the oil/gas and non-oil/gas sectors of $4.2 billion and $11.6 billion, respectively. Relative to last year, the services deficit was roughly unchanged in 2002. A narrowing of the oil/gas deficit was matched by a widening of the non-oil/gas deficit.

The narrower oil/gas deficit mainly occurred in non-freight services, which recorded a deficit of $3.7 billion; the freight services deficit rose to $0.6 billion, in line with rising oil and gas imports. By contrast, the widening non-oil/gas sector deficit came from freight services, which dropped by 10.1% owing to declining non-oil/gas imports.

In the meantime, the deficit on non-freight services for the non-oil/gas sector widened to $9.5 billion (4.1%). Even though foreign currency inflows in the form of transfers from Indonesian workers abroad increased and interest payment on foreign debts decline, the deficit on non-freight services was still widened. The wider deficit mainly originated in lower foreign currency revenues from tourism; larger payments for transportation services; and repatriation of profits by foreign investment companies and foreign companies. Tourism revenues (from 4.7 million visitors)



Graph 6.5
Non-Oil/Gas Import Share By Originating Region

dropped to $5.0 billion partly due to the impact of the Bali tragedy in October. By way of comparison, in 2001 tourism revenues were $5.3 billion (from 5.1 million visitors). During 2002, payments for transportation services rose by around 7.7%. Meanwhile, the rescheduling of government foreign loans amounting to $765 million contributed to a decline in foreign interest payments during the reporting year.

CAPITAL ACCOUNT

In the reporting year, the capital account was in a deficit of $3.6 billion, much narrower than the previous year's $9.0 billion. Both the private and government capital account made contributions in this regard; their deficits declined from $8.3 billion and $0.7 billion to $3.0 billion and $0.6 billion, respectively. As mentioned, the main factor was the rescheduling of government and private foreign debts.

On private capital account, the drop in the deficit originated in proceeds from divestment and privatization, net inflows of portfolio investment, and loan drawdowns by foreign investment companies. As further regards portfolio investment, several companies issued bonds abroad. A drop in payments on private foreign debts also made a contribution to the narrowing deficit.

On government capital account, the surplus originated from disbursement of IMF loans of $1.4 billion, project loans of $1.4 billion, and program loans of $0.8 billion. Specifically on IMF loans, drawings rose by $1.0 billion in 2002, following several delays during 2001, due to slow agreement on Letters of Intent between the IMF and the Indonesian government. The stronger government capital account also stemmed from successful debt rescheduling through the Paris and London Clubs.

During 2002, Indonesia's foreign debt dropped by 1.6% to $130.9 billion at year end (Table 6.7). This drop mainly originated in private debts, which fell sharply, by around $4.8 billion, as re-payments came due. Meanwhile, government debt rose by around $2.8 billion, largely due to the Japanese yen's appreciation against the dollar. The impact of this appreciation was quite significant because the share of government debt denominated in Japanese yen is around 33.7% of total government foreign debt.

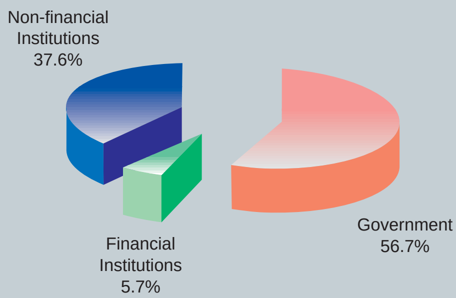
Government foreign debts at the end of the reporting year represented 56.7% of Indonesia's total foreign debts. Meanwhile, the shares of private financial and non-financial institutions' debts (including marketable securities) stood at 5.7% and 37.6%, respectively (Graph 6.6).

At the end of 2002, total outstanding government foreign debts amounted to $74.2 billion. Of that total, multilateral debts were $28.8 billion; bilateral debts were $26.2 billion; export credit facilities were $16.4 billion; leasing debts were $369 million, commercial debts were $2.3 billion; and debts in the form of

Millions of $

Table 6.7
Indonesia's Outstanding Foreign Debt

Item	2000	2001	2002			
			Mar	Jun	Sep	Dec *)
Government	74,916	71,377	71,677	74,157	73,464	74,197
Private	64,608	60,058	58,299	56,493	56,390	55,230
a. Financial institution	8,870	7,713	8,735	8,372	8,021	7,437
- Bank	7,720	6,649	6,309	5,848	5,164	4,869
- Non-bank	1,150	1,064	2,426	2,524	2,857	2,568
b. Non-financial institution	55,738	52,345	49,564	48,121	48,369	47,793
Securities	2,169	1,638	1,580	1,486	1,436	1,470
Total	141,693	133,073	131,556	132,136	131,290	130,897



Graph 6.6
Shares of Foreign Debt

marketable securities owned by foreign investors were $95 million.

At the same time, private foreign debts were $56.7 billion, down 8.1% from the end of 2001. Of that total, financial institutions' debt was $7.4 billion; non-financial institutions' was $47.8 billion; and marketable securities held by foreign investors totaled $1.5 billion.

Concerning the maturity of debts, short-term debts are estimated at $1.5 billion or 1.1% of Indonesia's total foreign debts. The remaining $129.4 billion is classified as being medium- and long-term debts. Of total short-term debt, government debt was only $0.1 billion. The rest are private short-term debt, comprising

Millions $

Table 6.8
Foreign Debts by Maturity

No.	Maturity	Dec 2002 *)					
		Govern-ment	Private				Total
			Financial Institution		Non-financial Institution 1)	Total Private	
			Bank	Non-bank			
1	Short-term 2)	95,3	338.8	116.8	928.3	1,383.8	1,479.1
2	Medium & Long term 3)	74,102.0	4,530.0	2,451.0	48,334.8	55,315.8	129,417.9
	Total	74,197.3	4,868.8	2,567.8	49,263.1	56,699.7	130,897.0

1) Including securities
2) Up to one year
3) More than one year

$0.5 billion owed by financial institutions and $0.9 billion by non-financial institutions (Table 6.8).

By economic sector, manufacturing was the largest sector being financed by foreign debts, amounted to $27.9 billion or 21.6% of total foreign debts. The second largest was the financial, leasing, and corporate services sector, which owed $23.2 billion or 17.9% of the total. Next was the electricity, gas, and clean water sector, holding $14.3 billion or 11.0% of total foreign debts.

Viewed by creditor country, Japan was the largest creditor with total outstanding loans of $38.9 billion or 29.7% of Indonesia's total foreign debt. The US was second with total outstanding loans of $11.9 billion (or 9.1%), followed by Singapore, the Netherlands, Germany, and Britain with total outstanding loans of $7.3 billion (5.6%), $6.4 billion (4.9%), $6.3 billion (4.8%), and $4.7 billion (3.6%), respectively. As was the case last year, international financial institutions such as the IBRD, IMF, and ADB constituted the largest institutional lenders with total outstanding loans reaching $10.7 billion (8.2%), $8.8 billion (6.7%), and $8.1 billion (6.2%), respectively.

With regard to debt restructuring, the reporting period was marked by conclusion of Paris Club II debt rescheduling in February 2002, with a rescheduled value on loan principal of $2.7 billion. This amount was the last of $5.8 billion in total foreign debts planned to be rescheduled under Paris Club phase II. The government also successfully rescheduled foreign debts maturing during 21 months up to the end of 2003 through the Paris Club phase III. By this agreement, the government delayed debt service (principal and interest) amounting to $5.4 billion, comprising debts falling due in 2002 of around $2.4 billion and those falling due during 2003 of around $3.0 billion. In relation to debt rescheduling through Paris Club III, the government also signed a debt swap agreement with Germany in the amount of DM50 million, to be aimed at improving the quality of education. Eight other countries such as Great Britain, Canada, France, Finland, Italy, New Zealand, Sweden, and Spain had also agreed to debt swap agreement. Within the frame of this agreement, Great Britain and Indonesia signed a Memorandum of Understanding (MoU) on June 12, 2002, concerning, Great Britain willingness to convert GBP100 million. Great Britain has agreed to increase the conversion program to GBP200 million should the initial arranged amount successfully implemented. Furthermore, under the principle of comparable treatment within the Paris Club agreement, the government also rescheduled foreign commercial debts, comprising principal and interest on 1995 syndicated loans and interest on 1996 and 1997 syndicated loans, with a total value of $1.3 billion through the London Club forum.[5]

There was also progress in the process of private foreign debt restructuring during 2002. Private foreign debt rescheduling through the Jakarta Initiative Task Force (JITF) reached a cumulative total of $18.9 billion or around 65.2% of delinquent foreign debts, owed by around 126 companies listed with JITF.[6] An improved settlement process was supported by relatively stable exchange rate, which eased cash projections of company's cash flow and maintained the consistency of the agreed amount of the debt to be rescheduled.

5 Consist of syndicated loans at 1995 in the amount of $300 million, at 1996 in the amount of $500 million, and at 1997 in the amount of $500 million.

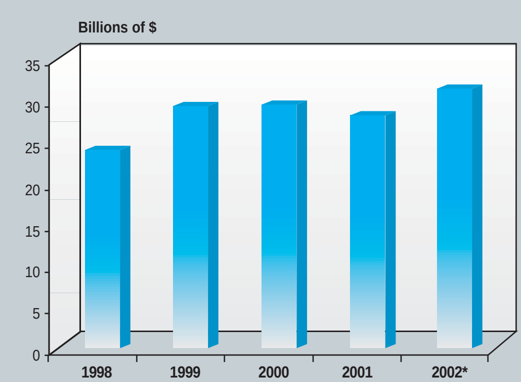
6 The debt that has been restructured until the signing of MoU comprising domestic and foreign debt, in both Rupiah and foreign currency. Source: JITF press release on December 20, 2002.

Percent

Table 6.9
Debt Burden Indicators

Indicator	1997	1998	1999	2000	2001	2002*)	World Bank Criteria
DSR	44.5	57.9	56.8	41.1	41.4	32.2	20
Outstanding debt/Export	207.3	261.8	252.1	191.0	200.7	194.0	130-220
Outstanding debt/GDP	62.2	146.3	105.0	93.8	91.1	68.7	50 - 80

Similarly, there was progress in the banking sector through Exchange Offer I and II (EO I and EO II) with agreements signed on 18 August 1998 and 25 May 1999. The EO I program, with total restructuring value of $3.0 billion, was completed with the fourth/last tranche of principal payments on 28 August 2002. Under the EO II program (with total restructuring value of $3.3 billion), the first tranche of payments on principal owed was made on 5 July 2002. Moreover during 2002, several debtors participating in the EO II program undertook buyback transactions, which reached a total of $330.1 million through the end of December 2002. As of that date, there was still $2.5 billion outstanding under the EO II program.



Graph 6.7
International Reserves

Other indicators give further evidence of easing in Indonesia's foreign debt burden and dependence upon offshore sources of financing (Table 6.9). In 2002, the debt service ratio (DSR) was 32.2%, whereas the ratios of total debt to exports and GDP were 194.0% and 68.7%, respectively, at year end. Both these ratios improved from the year before. Except for the DSR, these ratios were getting closer toward the normal ranges set by the World Bank. On the overall, these ratios reflect less foreign debt burden and Indonesia's dependency on overseas financing.

INTERNATIONAL RESERVES

With the balance of payments in an overall surplus of $3.6 billion, gross official international reserves rose by 12.7% during 2002, to $31.6 billion. This is equivalent to 6.6 months of imports plus government foreign debt payments (Graph 6.7).

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Bank Indonesia's Monitoring Concerning Foreign Exchange Flows in Non-Financial Institution Corporations

Based on Law No.24, 1999 regarding Foreign Exchange Flows (Lalu Lintas Devisa or LLD) and the Exchange Rate System, Bank Indonesia issued a series of regulations that required financial institutions (Banks and Non-Bank Financial Institutions/NBFIs) to submit reports on LLD to Bank Indonesia. Banks and NBFIs have done these LLD reports since 2000 and 2001, respectively. Since then, the monitoring of foreign exchange flows has improved, as has the quality of the reported data.

As a result of research, it is known that there are still a large number of LLD transactions conducted by residents, partly through demand deposits opened at banks abroad, with settlement conducted on a net basis. To address this issue, Bank Indonesia Regulation No.4/2/PBI/2002 regarding the Monitoring of LLD transactions by Non-financial Institution Corporations broadens the coverage of monitoring. This regulation requires non-financial institution corporations (or simply, corporations) to report their LLD transactions directly to Bank Indonesia.

In implementation, Bank Indonesia issued Circular Letter No.4/5/DSM dated 28 March 2002 Regarding Reporting on LLD Transactions by Non-Financial Institution Corporations. In light of the large number of corporations to be monitored and for the sake of continuation and consistency of LLD data, initially this regulation is only applied to business entities domiciled in Indonesia with assets (or annual volume of transactions) of Rp100 billion or more. The reporting obligation is effective for the LLD reporting period of May 2002. In subsequent stages, this regulation will be applied gradually to other corporations.

Under this regulation, corporations that conduct foreign exchange transactions are required to submit a report to Bank Indonesia on a routine basis covering the following:

1. Monthly LLD Reports of LLD transactions through overseas current accounts (OCA), inter-company/office accounts (ICA) and other instruments; and,
2. Semester Outstanding LLD Reports of corporate claims and liabilities to non-residents.

Since this LLD monitoring is quite new, corporations were given a trial period for reporting to Bank Indonesia, until the November 2002 reporting period. Administrative sanctions were to be effective starting with the December 2002 reporting period. However, since many corporations are still not prepared to fulfill certain administrative requirements, these sanctions will be delayed until the January 2004 reporting period.

To ensure smooth operations of the reporting system and to enhance the quality of the LLD data, a help desk is available at Bank Indonesia to provide advisory services for LLD reporting by corporations.

Through this regulation, comprehensive and accurate corporate LLD data would be obtained, complementary to the earlier LLD data from banks and NBFIs, to support of the formulation and effectiveness of monetary and other economic policies.

CHAPTER 7
Annual Report

Government Finance

CHAPTER

7 GOVERNMENT FINANCE

Government financial policy was directed towards fiscal consolidation to ensure sustainable state finances. In 2002, the central government budget deficit was 1.7% of GDP, below the level projected in the initial state budget.

Implementation of the state budget in 2002 was directed towards fiscal consolidation in order to ensure the sustainability of state finances in the future. To this end, several policy measures in the 2002 budget were successfully implemented, including quite a significant reduction in subsidies, a partial reprofiling of domestic debt (Box: Reprofiling Government Bonds) and a rescheduling of government foreign debt. However, several other measures were postponed, such as the imposition of value added tax on the Island of Batam.[1] In addition, the government has faced considerable challenges in fiscal adjustment due to developments in macroeconomic variables—particularly domestic interest rates and the absorption of offshore loans—which were out of line with original budgetary assumptions.

Policy towards government revenue mainly concerne the taxation and covered efforts in strengthening collections and broadening the tax base, as well as increasing services for taxpayers. Notable efforts to strengthen collections covered: (i) a rise in the effective income tax rate for certain corporate taxpayers from 1,0% to 2,0% of turnover; (ii) a rise in the tax on bond interest from 15,0% to 20,0%; as well as (iii) imposition of a tax on capital gains from asset sales (excluding the Jakarta Initiative) in the framework of restructuring. Efforts to broaden the tax base included: (i) enhancement and widening of the tax audit program; (ii) intensive identification and monitoring of the 400 largest late tax payers; and (iii) development of a data bank in cooperation with various related parties.

Despite the implementation of these various policies, the tax ratio is estimated to be only 12.7% of GDP, below the budget target of 13.0% of GDP. This under performance mainly occurred in the most important components of tax revenue, namely non-oil/gas income tax and value added tax, as well as the excise on acquisition of land and building rights (BPHTB) and tax on international trade. This is due to: (i) the postponement of several measures, such as imposition of value added tax on the Island of Batam and value added tax on services related to toll road operations; (ii) the financial condition of large corporations, particularly foreign investment corporations, which still operated at a loss; and (iii) a slowdown in export-based industries, particularly shoes, garments, electronics, and wood-product industries.

By contrast, non-tax revenues made quite a significant contribution to covering the shortfalls in tax revenues. This revenue component reached around 5.3% of GDP, higher that its original target of 4.9% of GDP.

1 In 2002, the Government enacted the Law on Government Treasury Notes which provided for a "standing appropriation", to reassure the market regarding the repayment of government debt principal and interest (Box: Law No.24, 2002 regarding Government Treasury Notes).

This over realization of non-tax revenue was mainly due to unexpected revenues from oil and gas (oil windfalls profit) and other non-tax revenues, such as year 2001 revenues that were received in 2002. Total government revenues and grants are estimated to have reached 18.0% of GDP, very close to the original budgetary target.

On the side of expenditure, important policies included a reduction of subsidies and an easing of the loan interest burden through a buy-back policy. With these various policies on expenditures, it is estimated that government expenditure was contained to 19.7% of GDP, which is slightly lower than the original target of 20.4% of GDP. Viewed by the broadest categories of government expenditure, routine spending came in a bit below target (2.4%); development expenditure was 23.0% below target; while expenditure budgeted for the regions was virtually on-target.

On the macroeconomic side, implementation of the state budget also faced pressures due to economy-wide outcomes that were different than original estimates. The most significant pressure came from the interest rate on 3-month SBIs that averaged 15.2%, considerably higher than the original estimate of 14.0%

Table 7.1
Development of State Budget Assumptions

Assumptions	Budget-SBC 2001[1]	Budget 2002	Budget-R 2002	Realization 2002[2]
Nominal GDP (trillions of rupiah)	1,491	1,685	1,716	1,668
Economic growth (%)	3.5	4.0	4.0	3.6
Inflation rate (%)	11.9	9.0	9.5	10.03
Crude oil price ($/barrel)	24.6	22.0	22.8	24.1
Oil production				
(millions of barrel/day)	1.27	1.32	1.26	1.26
Exchange rate (Rp/$)	10,219	9,000	9,280	9,311
Average 3 months SBI rates (%)	16.4	14.0	15.7	15.2

1) State Budget Calculation
2) Provisional realization (revision IV, January 2003)
Sources : Ministry of Finance

per year. This caused the interest burden on domestic loans to exceed the budgetary allocation. The estimated figures for other macroeconomic aggregates are presented in Table 7.1.

Although implementation of the state budget faced various challenges, the government estimates that the deficit on government financial operations was held to some 1.7% of GDP, a bit lower than the original estimate of 2.5% of GDP. This deficit was mainly financed by proceeds from privatization and sales of assets under the bank restructuring program. As a consequence, the fiscal stimulus (or direct government contribution to aggregate demand) is estimated to only reach 11.8% of GDP, lower than the original plan of 12.5% of GDP. This contribution was accounted for by consumption spending of 7.0% of GDP and investment spending of 4.8% of GDP. On the monetary side, development of government expenditures is estimated to remain quite supportive of monetary policy, despite government net rupiah expansion having reached Rp19.5 trillion (versus the original plan of Rp15.4 trillion). Bank Indonesia would be able to absorb all of this amount, since during the same period there were net foreign currency inflows from the government sector equivalent to Rp24.3 trillion.

Compared with last year's budgetary outcome, the government's financial operations generally improved in the reporting year. This is reflected in several indicators, such as a higher tax ratio (12.7% of GDP in 2002 versus 12.4% of GDP in 2001), a smaller budget deficit (1.7% of GDP in 2002 relative to 2.7% of GDP in 2001) and a smaller rupiah impact of government finances on monetary control operations (1.2% of GDP in 2002 versus 2.2% in 2001).

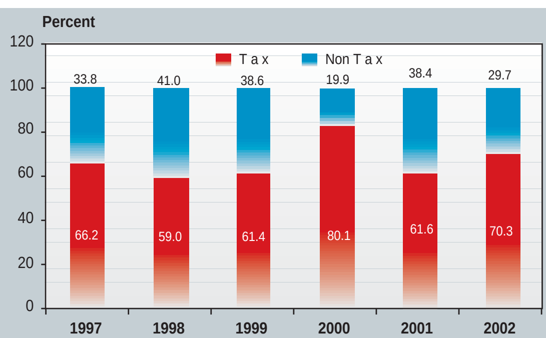
GOVERNMENT REVENUES AND GRANTS

Total government revenues and grants are expected to reach the targeted amount. In nominal terms, the realization for 2002 would reach Rp300.2 trillion or 0.6% below target. In percentage of GDP, revenues reached 18.0%, slightly above the budgetary target of 17.9%. Compared with last year, the ratio of government revenues and grants to GDP in 2002 was lower than 2001, when it reached 20.2% of GDP. In general, this was due to lower oil prices and a stronger exchange rate.

The main contributor to government revenues continued to be tax revenues, which covered 70.3% of total revenues. However, the tax ratio was only 12.7% of GDP, somewhat below the target of 13.0% of GDP. Relatively low taxes mainly originated in the most important components of tax revenues, namely non-oil/gas income tax and value added tax. This was due to postponement of the implementation of several tax measures and economic activity that was lower than assumed. By contrast, non-tax revenues were stronger than expected. Although the budgetary target had been set at a relatively conservative level, realization of non-tax revenues reached 5.3% of GDP, appreciably above the budgetary target of 4.9% of GDP. This over-performance was accounted for by oil and natural gas revenues and other non-tax revenues. These exceeded their targets, due to, among others, inflows of off-budget funds and reimbursements of overpayments of fuel subsidies in 2001. This reimbursement was in accordance with the results of an audit conducted by the Finance and Development Supervisory Board (BPKP; Graph 7.1).

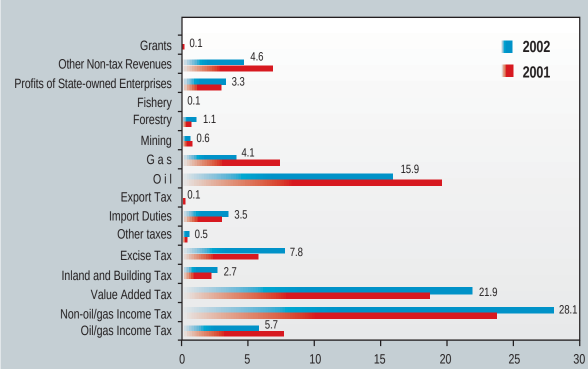
As mentioned, non-oil/gas income tax and value added tax remained the two main sources of government revenues (shares of 28.1% and 21.9% respectively). Although these two components did not reach their targets in 2002, revenues were higher than last year. The third largest revenue source was non-tax revenue from oil, with a share of 15.9%. This component exceeded its target, although it was down from last year (Graph 7.2 and Table 7.2).

Most other important revenue components (such as oil and gas income tax and excise tax) exceed their targets, while non-tax revenue from natural gas



Notes:
1) Data is processed from fiscal year to calendar year
2) 1997-2001 State Budget Calculation (SBC); 2002 Provisional realization (unaudited) period of January 1- December 31, 2002 (revision IV-January 2003)

Graph 7.1
Developments of Tax Revenues and Non-Tax Revenues (% of Government Revenues)



Graph 7.2
Components of Government Revenues

(Trillions of Rp)

Table 7.2
Government Revenues and Grants

Item	2001		2002						
	Budget-SBC [1]		Budget		Budget-R [2]		Realization [3]		
	Nominal	% of GDP	Nominal	% of GDP	Nominal	% of GDP	Nominal	% of GDP	Change[4]
Goverment Revenues and Grants	**301.08**	**20.19**	**301.87**	**17.91**	**305.15**	**17.78**	**300.19**	**18.00**	**(2.20)**
I. Domestic Revenues	**300.60**	**20.16**	**301.87**	**17.91**	**304.89**	**17.76**	**299.89**	**17.98**	**(2.18)**
1. Tax Revenues	**185.54**	**12.44**	**219.63**	**13.03**	**214.71**	**12.51**	**210.95**	**12.65**	**0.20**
a. Domestic taxes	175.97	11.80	207.03	12.28	202.57	11.80	200.32	12.01	0.21
i. Income tax	94.58	6.34	104.50	6.20	103.31	6.02	101.68	6.10	(0.25)
1. Oil and gas	23.10	1.55	15.68	0.93	16.11	0.94	17.22	1.03	(0.52)
2. Non-oil and gas	71.47	4.79	88.82	5.27	87.20	5.08	84.46	5.06	0.27
ii. Value added tax	55.96	3.75	70.10	4.16	67.80	3.95	65.85	3.95	0.20
iii. Land tax and building	5.25	0.35	5.92	0.35	6.03	0.35	6.36	0.38	0.03
iv. Excise on land and building transfer	1.42	0.10	2.21	0.13	1.50	0.09	1.63	0.10	0.00
v. Excise tax	17.39	1.17	22.35	1.33	22.47	1.31	23.34	1.40	0.23
vi. Other taxes	1.38	0.09	1.95	0.12	1.46	0.08	1.47	0.09	(0.00)
b. International trade taxes	9.57	0.64	12.60	0.75	12.14	0.71	10.63	0.64	(0.00)
i. Import duties	9.03	0.61	12.25	0.73	11.84	0.69	10.40	0.62	0.02
ii. Export tax	0.54	0.04	0.35	0.02	0.31	0.02	0.23	0.01	(0.02)
2. Non-tax Revenues	**115.06**	**7.72**	**82.25**	**4.88**	**90.18**	**5.25**	**88.93**	**5.33**	**(2.38)**
a. Natural resource revenues	85.67	5.75	63.20	3.75	68.00	3.96	65.22	3.91	(1.84)
i. Oil	58.95	3.95	44.01	2.61	47.68	2.78	47.69	2.86	(1.09)
ii. Gas	22.09	1.48	14.52	0.86	16.35	0.95	12.33	0.74	(0.74)
iii. Mining	2.32	0.16	1.34	0.08	1.43	0.08	1.85	0.11	(0.04)
iv. Forestry	2.24	0.15	3.03	0.18	2.36	0.14	3.15	0.19	0.04
v. Fishery	0.07	0.00	0.29	0.02	0.19	0.01	0.20	0.01	0.01
b. Profit transfer from SOEs	8.84	0.59	10.35	0.61	10.91	0.64	9.76	0.59	(0.01)
c. Other non-tax revenues	20.55	1.38	8.70	0.52	11.27	0.66	13.95	0.84	(0.54)
II. Grants	**0.48**	**0.03**	**-**	**-**	**0.26**	**0.01**	**0.30**	**0.02**	**(0.01)**

1) State Budget Calculation : realization period of January 1-December 31, 2001 (audited)
2) Revised State Budget (R) : estimated realization
3) Provisional Realization period of January 1-December 31, 2002 (revision IV, January 2003)
4) Difference between share of each post in 2002 State Budget to GDP with that of 2001 State Budget Calculation to GDP

Source : Ministry of Finance and Bank Indonesia (processed)

was below target. As was the case for non-tax revenue from oil, receipt from non-tax revenue from natural gas declined relative to the previous year in line with lower international oil prices and the strengthening of rupiah exchange rate. By contrast, revenues from the excise tax rose significantly relative to last year, due to expanding production of taxable goods and the impact of several policies, such as the elimination of unbranded cigarettes and intensive monitoring of retail sales prices of goods subject to excise tax.

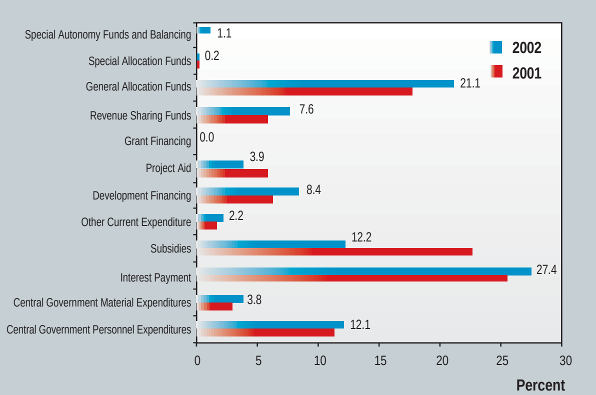
GOVERNMENT EXPENDITURES

Realization of government expenditures is below target. In nominal terms, realizations reached Rp327.9 trillion or 4.7% below target; in percentage of GDP, they were 19.7% or below the budget plan of 20.4%. Relative to last year, this percentage is down appreciably; in 2001, it was 22.9%. The decline in 2002 is mainly due to a significant drop in funds allocated for subsidies.

By major expenditure category, central government routine expenditure was 57.7% of total government expenditures, followed by regional budget expenditure (30.0%) and development expenditures (12.3%). Compared with budget plans, central government routine expenditures (2.4%) and development expenditures (23.0%) under budget estimates, whereas budget allocation for regional expenditure were a bit higher than budgeted. Other notable budget allocations included interest on loans (27.4% of total government expenditures), general allocation funds for the regions (21.1%) and subsidies (12.2%; Graph 7.3).

Spending was lower than budgetary allocations in almost all components of routine expenditures, except for interest payments on domestic debt. The excessive allocation for interest payments on domestic debt was due to higher average interest rates on 3-month SBIs (which is the reference point for the interest rate on domestic bonds), and to postponed payments on bank recapitalization bonds. The later was scheduled to start at the beginning of the budget year, but implementation only began at the end of the third quarter.

Transfers to regions within their budgetary allocation was due to improved implementation of regional autonomy, which started at the beginning of 2001. The largest allocation continued to be for general allocation funds, which comprised more than two-thirds of total transfers to regions. Compared with last year, most categories of regional transfers experienced quite significant increases, including for a new account entitled Funds for Special Autonomy and Balancing. This account represented budgetary allocations for a 50.0% increase in the education allowance for teachers, effective October 2002.



Graph 7.3
Components of Government Expenditures

Low spending on development expenditures was attributable to technical and administrative constraints in drawdowns of offshore loans and low absorption of project loans. These loans were mainly for transportation and energy projects that had been postponed since budget year 1997/1998 due to the economic crisis. Aside from that, project loans were also used for cost recovery projects and for projects with significant spillovers.[2] Compared with the previous year, development expenditures in 2002 were virtually unchanged (Table 7.3).

DEFICIT AND FINANCING

Based upon government revenues and expenditures described above, the fiscal deficit in 2002 was Rp27.7 trillion or equivalent to 1.7% of GDP (Table 7.4), lower than budgeted, Rp42.1 trillion or 2.5% of GDP. The bulk of this deficit was financed by proceeds from the privatization of state-owned enterprises and sales of assets under the bank restructuring program. The remainder was largely

2 Cost recovery projects are those that produce revenues for the repayment of the loans and for the operation and maintenance of the projects. Projects with spillovers are those that give benefits to the public at large including outside the project location.

Table 7.3
Government Expenditures

Item	2001		2002						
	Budget-SBC 1)		Budget		Budget-R 2)		Realization 3)		
	Nominal	% of GDP	Nominal	% of GDP	Nominal	% of GDP	Nominal	% of GDP	Change4)
Government Expenditures	**341.56**	**22.91**	**344.01**	**20.41**	**345.60**	**20.13**	**327.86**	**19.66**	**(3.25)**
I. Central Government Expenditures	**260.51**	**17.47**	**246.04**	**14.60**	**247.80**	**14.44**	**229.34**	**13.75**	**(3.72)**
1. Routine Expenditures	**218.92**	**14.68**	**193.74**	**11.50**	**200.38**	**11.67**	**189.07**	**11.34**	**(3.35)**
a. Personnel expenditures	38.71	2.60	41.30	2.45	42.20	2.46	39.69	2.38	(0.22)
b. Material expenditures	9.93	0.67	2.86	0.76	13.90	0.81	12.43	0.75	0.08
c. Interest payment	87.14	5.84	88.50	5.25	91.54	5.33	89.87	5.39	(0.46)
i. Domestic interest	58.20	3.90	59.52	3.53	63.21	3.68	64.46	3.86	(0.04)
ii. Foreign interest	28.95	1.94	28.98	1.72	28.32	1.65	25.41	1.52	(0.42)
d. Subsidies	77.44	5.19	41.59	2.47	42.64	2.48	40.01	2.40	(2.80)
i. Oil subsidies	68.38	4.59	30.38	1.80	31.16	1.82	31.16	1.87	(2.72)
ii. Non-oil subsidies	9.06	0.61	11.21	0.67	11.47	0.67	8.84	0.53	(0.08)
- Rice (BULOG)	-	-	4.70	0.28	4.70	0.27	-	-	-
- Electricity	-	-	4.11	0.24	4.10	0.24	-	-	-
- Credit program	-	-	2.20	0.13	2.47	0.14	-	-	-
- Others	-	-	0.20	0.01	0.20	0.01	-	-	-
e. Other routine expenditure	5.69	0.38	9.49	0.56	10.11	0.59	7.08	0.42	0.04
2. Development Expenditures and Net Lending	**41.59**	**2.79**	**52.30**	**3.10**	**47.41**	**2.76**	**40.27**	**2.41**	**(0.37)**
a. Rupiah financing	21.37	1.43	26.47	1.57	27.19	1.58	27.64	1.66	0.22
b. Project aid	20.21	1.36	25.83	1.53	20.22	1.18	12.63	0.76	(0.60)
II. Regional Budget Expenditures	**81.05**	**5.44**	**97.97**	**5.81**	**97.81**	**5.70**	**98.52**	**5.91**	**0.47**
1. Balance Budget	**81.05**	**5.44**	**94.53**	**5.61**	**94.04**	**5.48**	**94.76**	**5.68**	**0.25**
a. Revenue sharing funds	20.01	1.34	24.60	1.46	24.27	1.41	24.99	1.50	0.16
b. General allocation funds	60.35	4.05	69.11	4.10	69.11	4.03	69.14	4.15	0.10
c. Special allocation funds	0.70	0.05	0.82	0.05	0.66	0.04	0.64	0.04	(0.01)
2. Special autonomy	-	**-**	**3.44**	**0.20**	**3.77**	**0.22**	**3.76**	**0.23**	**0.23**

1) State Budget Calculation : realization period of January 1-December 31, 2001 (audited)
2) Revised State Budget (R) : estimated realization
3) Provisional Realization period of January 1-December 31, 2002 (revision IV, January 2003)
4) Difference between share of each post in 2002 State Budget to GDP with that of 2001 State Budget Calculation to GDP

Source : Ministry of Finance and Bank Indonesia (processed)

financed by net drawings on offshore loans. Revenues from privatization of state-owned enterprises are estimated to amount to Rp7.7 trillion or 93.9% above the target; sales of IBRA assets are estimated to meet the budget target.

Net financing from offshore sources is estimated to end the year below target, owing to absorption of offshore loans having reached only 54.8% of the original plan. This low level of absorption occurred mainly in project loans, which reached only 47.7% of budgeted amounts; program loans reached 73.9%. Loan repayments are also estimated to be below target, at only 73.3% of the planned amount. This was mainly due to the depreciation of US dollar against regional currencies, particularly the yen, while Japan is the largest lender to Indonesia (Graph 7.4).

On the domestic financing side, during the reporting period, the government budgeted Rp1.9 trillion for the refinancing of maturing government bonds, below the original plan of Rp3.9 trillion.

(Trillions of Rp)

Table 7.4
Estimated Realization of Government Financial Operation

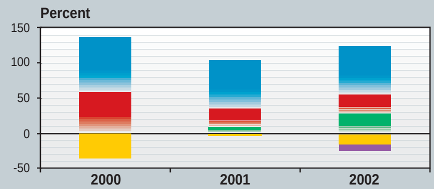
Item	2001 Budget-SBC [1] Nominal	2001 Budget-SBC [1] % of GDP	2002 Budget Nominal	2002 Budget % of GDP	2002 Budget-R [2] Nominal	2002 Budget-R [2] % of GDP	2002 Realization [3] Nominal	2002 Realization [3] % of GDP	2002 Realization [3] Change[4]
A. Government Revenues and Grants	**301.08**	**20.19**	**301.87**	**17.91**	**305.15**	**17.78**	**300.19**	**18.00**	**(2.20)**
I. Domestic Revenues	**300.60**	**20.16**	**301.87**	**17.91**	**304.89**	**17.76**	**299.89**	**17.98**	**(2.18)**
1. Tax Revenues	**185.54**	**12.44**	**219.63**	**13.03**	**214.71**	**12.51**	**210.95**	**12.65**	**0.20**
2. Non-tax Revenues	**115.06**	**7.72**	**82.25**	**4.88**	**90.18**	**5.25**	**88.93**	**5.33**	**(2.38)**
II. Grants	**0.48**	**0.03**	**-**	**-**	**0.26**	**0.01**	**0.30**	**0.02**	**(0.01)**
B. Government Expenditures	**341.56**	**22.91**	**344.01**	**20.41**	**345.60**	**20.13**	**327.86**	**19.66**	**(3.25)**
I. Central Government Expenditures	**260.51**	**17.47**	**246.04**	**14.60**	**247.80**	**14.44**	**229.34**	**13.75**	**(3.72)**
1. Current Expenditure	**218.92**	**14.68**	**193.74**	**11.50**	**200.38**	**11.67**	**189.07**	**11.34**	**(3.35)**
2. Development expenditure and net lending	**41.59**	**2.79**	**52.30**	**3.10**	**47.41**	**2.76**	**40.27**	**2.41**	**(0.31)**
II. Regional Budget Expenditure	**81.05**	**5.44**	**97.97**	**5.81**	**97.81**	**5.70**	**98.52**	**5.91**	**0.47**
1.Balance Budget	**81.05**	**5.44**	**94.53**	**5.61**	**94.04**	**5.48**	**94.76**	**5.68**	**0.25**
2. Special Autonomy Fund and Balancing	**-**	**-**	**3.44**	**0.20**	**3.77**	**0.22**	**3.76**	**0.23**	**0.23**
C. Primary Balance	**46.66**	**3.13**	**46.36**	**2.75**	**51.08**	**2.98**	**62.19**	**3.73**	**0.60**
Statistical Discrepancy	**0.00**		**0.00**		**0.00**		**(0.00)**		
D. Budget Surplus/(Deficit)	**(40.48)**	**(2.72)**	**(42.14)**	**(2.50)**	**(40.46)**	**(2.36)**	**(27.68)**	**(1.66)**	**1.06**
E. Financing	**40.49**	**2.72**	**42.13**	**2.50**	**40.45**	**2.36**	**27.68**	**1.66**	**(1.06)**
I. Domestic Financing	**30.22**	**2.03**	**23.50**	**1.39**	**24.19**	**1.41**	**20.56**	**1.23**	**(0.79)**
1. Domestic banks financing	**(1.23)**	**(0.08)**	**-**	**-**	**0.20**	**0.01**	**(4.71)**	**(0.28)**	**(0.20)**
a. Moneatary authority	(1.23)	(0.08)	-	-	0.20	0.01	(4.71)	(0.28)	(0.20)
b. Credit/Loans of banking sector	-	-	-	-	-	-	-	-	-
c. Monetary correction	-	-	-	-	-	-	-	-	-
2. Non-domestic banks financing	**31.45**	**2.11**	**23.50**	**1.39**	**23.99**	**1.40**	**25.27**	**1.52**	**(0.59)**
a. Privatization proceed	3.47	0.23	3.95	0.23	4.44	0.26	7.66	0.46	0.23
b. Recovery of bank asset	27.98	1.88	19.55	1.16	19.55	1.14	19.55	1.17	(0.70)
c. Government bonds	-	-	-	-	-	-	(1.94)	(0.12)	(0.12)
II. Foreign Financing (Net)	**10.27**	**0.69**	**18.63**	**1.11**	**16.26**	**0.95**	**7.12**	**0.43**	**(0.26)**
1.Gross Drawing	**26.15**	**1.75**	**35.36**	**2.10**	**29.31**	**1.71**	**19.37**	**1.16**	**(0.59)**
a. Program aid	6.42	0.43	9.53	0.57	9.35	0.54	7.04	0.42	(0.01)
b. Project aid	19.74	1.32	25.83	1.53	19.96	1.16	12.33	0.74	(0.58)
2. Amortization	**(15.88)**	**(1.07)**	**(16.73)**	**(0.99)**	**(13.05)**	**(0.76)**	**(12.26)**	**(0.73)**	**0.33**

1) State Budget Calculation : realization period of January 1-December 31, 2001 (audited)
2) Revised State Budget (R) : estimated realization
3) Provisional Realization period of January 1-December 31, 2002 (revision IV, January 2003)
4) Difference between share of each post in 2002 State Budget to GDP with that of 2001 State Budget Calculation to GDP

Source : Ministry of Finance and Bank Indonesia (processed)

IMPACT OF GOVERNMENT FINANCIAL OPERATIONS ON THE REAL SECTOR

In 2002, fiscal stimulus through government consumption and investment spending is estimated to reach 11.8% of GDP, a bit below the target of 12.5% of GDP. The bulk (7.0% of GDP) was accounted for by consumption, particularly for general allocation funds for the regions and central



	2000	2001	2002
Sell (+)/Buy (-) SUN	0.0	0.0	-7.0
UBF (+= contr; - = exp)	-36.1	-3.0	-17.0
I B R A	78.1	69.1	70.6
Net off-shore loans	57.8	25.4	25.7
Privatization	0.1	8.6	27.7

UBF = Unused Budgetary Funds, (contr = contraction, exp = expansion)

Graph 7.4
Components of Deficit Financing

government employee expenditures. The remainder stemmed from investment spending in the form of rupiah financing and shared revenue funds for the regions (Table 7.5).

In addition to this fiscal stimulus, the government also made transfers to the private sector in the forms of subsidies and interest payments on domestic loans. The largest were the interest payments that reached 3.9% of GDP, above the target; subsidies amounted to 2.4% of GDP.

The government contribution to aggregate demand, particularly in the form of investment, was quite limited. Low government investment was partly due to constraints in drawdowns of offshore loans, namely technical and administrative constraints as well as shortfalls in implementing policy matrix with lenders (Graph 7.5). On the other hand, government consumption increased, particularly in the form of fund balancing for the regions.

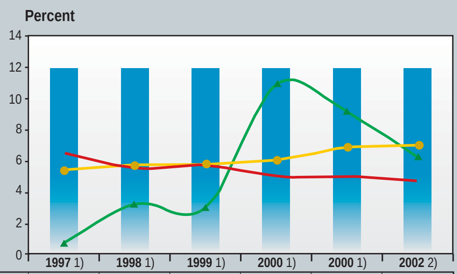
(Trillions of Rp)

Table 7.5
Fiscal Stimulus

Item	2001		2002						
	Budget-SBC 1)		Budget		Budget-R 2)		Realization 3)		
	Nominal	% of GDP	Nominal	% of GDP	Nominal	% of GDP	Nominal	% of GDP	Change 4)
I. Government Consumptions	**102.87**	**6.90**	**120.01**	**7.12**	**122.81**	**7.16**	**117.06**	**7.02**	**0.12**
Domestic Personnel Expenditures	38.71	2.60	39.80	2.36	40.65	2.37	38.79	2.33	(0.27)
Domestic Material Expenditures	9.93	0.67	11.71	0.69	12.71	0.74	11.84	0.71	0.04
General Allocation Funds	48.53	3.25	55.58	3.30	55.58	3.24	55.60	3.33	0.08
Special Autonomy	-	-	3.44	0.20	3.77	0.22	3.76	0.23	0.23
Other Routine Expenditures	5.69	0.38	9.49	0.56	10.11	0.59	7.08	0.42	0.04
II. Gross Domestic Fixed Capital Formation	**74.11**	**4.97**	**91.25**	**5.41**	**85.87**	**5.00**	**79.44**	**4.76**	**(0.21)**
Rupiah financing	21.37	1.43	26.47	1.57	27.19	1.58	27.64	1.66	0.22
Project Aid	20.21	1.36	25.83	1.53	20.22	1.18	12.63	0.76	(0.60)
General Allocation Funds	11.82	0.79	13.53	0.80	13.53	0.79	13.54	0.81	0.02
Revenue Sharing and Special Allocation Funds	20.71	1.39	25.42	1.51	24.92	1.45	25.63	1.54	0.15
III. Total I + II	**176.98**	**11.87**	**211.26**	**12.54**	**208.69**	**12.16**	**196.49**	**11.78**	**(0.09)**
Memo Items : Transfer Payment	135.64	9.10	101.11	6.00	105.85	6.17	104.47	6.26	(2.83)
a. Domestic interest	58.20	3.90	59.52	3.53	63.21	3.68	64.46	3.86	(0.04)
b. Subsidies	77.44	5.19	41.59	2.47	42.64	2.48	40.01	2.40	(2.80)

1) State Budget Calculation : realization period of January 1-December 31, 2001 (audited)
2) Revised State Budget (R) : estimated realization
3) Provisional Realization period of January 1-December 31, 2002 (revision IV, January 2003)
4) Difference between share of each post in 2002 State Budget to GDP with that of 2001 State Budget Calculation to GDP

Source : Ministry of Finance and Bank Indonesia (processed)



	1997 1)	1998 1)	1999 1)	2000 1)	2000 1)	2002 2)
Govt. Expenditure	11.9	11.2	11.5	11.1	11.9	11.8
Consumption	5.4	5.7	5.7	6.1	6.9	7.0
Investment	6.5	5.5	5.8	5.0	5.0	4.8
Transfer Payment 3)	0.7	3.2	3.0	10.9	9.1	6.3

Notes:
1) Data is processed from fiscal year to calendar year
2) 1997-2001 State Budget Calculation (SBC); 2002 Provisional ralization (unaudited) period of January 1- December 31, 2002 (revision IV-January 2003)
3) Consist of Interest Payments Domestic Debt and Subsidies

Graph 7.5
Impact of Government Financial Operations on The Real Sector (% of GDP Based On Current Prices)

RUPIAH IMPACT OF GOVERNMENT FINANCIAL OPERATIONS

During 2002, government financial operations in rupiah are estimated to have had a net expansionary impact of Rp19.5 trillion on money in circulation. This is higher by around 26.7% than budgeted, particularly due to tax revenues being below target and interest payments on domestic loans that were higher than planned.

Government expenditures were less expansionary in 2002 than 2001, rupiah expansion having dropped

(Trillions of Rp)

Table 7.6
Rupiah Impact of Government Financial Operations

Item	2001		2002						
	Budget-SBC 1)		Budget		Budget-R 2)		Realization 3)		
	Nominal	% of GDP	Nominal	% of GDP	Nominal	% of GDP	Nominal	% of GDP	Change 4)
A. Revenues in Rupiah									
Taxes									
Oil and Gas	23.10	1.55	15.68	0.93	16.11	0.94	17.22	1.03	(0.52)
Non-oil and gas	162.44	10.89	203.94	12.10	196.32	11.44	191.46	11.48	0.58
Non-taxes	60.55	4.06	43.52	2.58	47.61	2.77	50.38	3.02	(1.04)
Privatization proceeds	0.99	0.07	1.13	0.07	1.27	0.07	2.19	0.13	0.06
Recovery of bank asset	17.20	1.15	12.02	0.71	12.02	0.70	12.02	0.72	(0.43)
Government bonds	-	-	-	-	-	-	(1.94)	(0.12)	(0.12)
Total Revenues	**264.27**	**17.72**	**276.29**	**16.39**	**273.33**	**15.92**	**271.32**	**16.27**	**(1.46)**
B. Expenditure in Rupiah									
Operational	(189.98)	(12.74)	(162.11)	(9.62)	(169.31)	(9.86)	(162.17)	(9.72)	3.02
Domestic Personnel	(38.71)	(2.60)	(39.80)	(2.36)	(40.65)	(2.37)	(38.79)	(2.33)	0.27
Subsidies	(77.44)	(5.19)	(41.59)	(2.47)	(42.64)	(2.48)	(40.01)	(2.40)	2.80
Domestic Interest Payment	(58.20)	(3.90)	(59.52)	(3.53)	(63.21)	(3.68)	(64.46)	(3.86)	0.04
Other Routine Expenditure	(15.62)	(1.05)	(21.20)	(1.26)	(22.82)	(1.33)	(18.91)	(1.13)	(0.09)
Investment	(25.41)	(1.70)	(31.64)	(1.88)	(31.24)	(1.82)	(30.17)	(1.81)	(0.10)
Balance budget	(81.05)	(5.44)	(97.97)	(5.81)	(97.81)	(5.70)	(98.52)	(5.91)	(0.47)
Total Expenditures	**(296.45)**	**(19.88)**	**(291.71)**	**(17.31)**	**(298.36)**	**(17.38)**	**(290.86)**	**(17.44)**	**2.44**
C. Statistical Discrepancy	**0.00**		**0.00**		**0.00**		**(0.00)**		
D. Rupiah Impact	**(32.17)**	**(2.16)**	**(15.42)**	**(0.92)**	**(25.03)**	**(1.46)**	**(19.54)**	**(1.17)**	**0.99**

1) State Budget Calculation : realization period of January 1-December 31, 2001 (audited)
2) Revised State Budget (R) : estimated realization
3) Provisional Realization period of January 1-December 31, 2002 (revision IV, January 2003)
4) Difference between share of each post in 2002 State Budget to GDP with that of 2001 State Budget Calculation to GDP

Source : Ministry of Finance and Bank Indonesia (processed)

by Rp32.2 trillion to around Rp19.5 trillion. This drop was accounted for by the sharp drop in subsidy payments, from Rp77.4 trillion to Rp40.0 trillion (Table 7.6).

FOREIGN CURRENCY IMPACT OF GOVERNMENT FINANCIAL OPERATIONS

During 2002, government financial operations on foreign currency are estimated to have resulted in net foreign currency inflows equivalent to Rp24.3 trillion, or higher than the total of government net rupiah expansion, mentioned above. This figure was 57.3% above the original target, mainly due to the average exchange rate having reached Rp9,311, compared with the budgetary assumption of Rp9,000 per US dollar, and to oil and gas revenues being higher than budgeted. Bank Indonesia used these net foreign inflows on government account to buy rupiah in the foreign exchange market, which had a net contractionary impact (sterilization) virtually identical to the government's net expansionary operations in rupiah.

Net foreign currency inflows declined from 2001 to 2002. This was partly due to the appreciation of the rupiah and a decline in oil production and prices (Table 7.7).

(Trillions Rp)

Table 7.7
Foreign Currency Impact of Government Financial Operations

Item	2001		2002						
	Budget-SBC[1]		Budget		Budget-R [2]		Realization[3]		
	Nominal	% of GDP	Nominal	% of GDP	Nominal	% of GDP	Nominal	% of GDP	Change[4]
A. Current Account	**9.88**	**0.66**	**(13.57)**	**(0.80)**	**(2.14)**	**(0.12)**	**4.13**	**0.25**	**(0.41)**
Trade balance	38.34	2.57	18.07	1.07	26.39	1.54	28.45	1.71	(0.87)
Oil and gas export	54.51	3.66	38.73	2.30	42.57	2.48	38.55	2.31	(1.34)
Project aid import	(16.17)	(1.08)	(20.66)	(1.23)	(16.18)	(0.94)	(10.11)	(0.61)	0.48
Services account	(28.47)	(1.91)	(31.63)	(1.88)	(28.53)	(1.66)	(24.32)	(1.46)	0.45
Foreign debt	(28.95)	(1.94)	(28.98)	(1.72)	(28.32)	(1.65)	(25.41)	(1.52)	0.42
Foreign debt interest payment	-	-	(1.50)	(0.09)	(1.55)	(0.09)	(0.90)	(0.05)	(0.05)
Foreign personnel expenditure	-	-	(1.16)	(0.07)	(1.19)	(0.07)	(0.60)	(0.04)	(0.04)
Foreign material expenditure	-	-	-	-	2.28	0.13	2.28	0.14	0.14
Non-oil/gas income tax	0.48	0.03	-	-	0.26	0.01	0.30	0.02	(0.01)
Grants									
B. Net Official Capital Inflows	**23.52**	**1.58**	**28.99**	**1.72**	**26.97**	**1.57**	**20.12**	**1.21**	**(0.37)**
Foreign debt disbursment	26.15	1.75	35.36	2.10	29.31	1.71	19.37	1.16	(0.59)
Foreign debt amortization	(15.88)	(1.07)	(16.73)	(0.99)	(13.05)	(0.76)	(12.26)	(0.73)	0.33
Privatization proceeds	2.48	0.17	2.82	0.17	3.17	0.18	5.48	0.33	0.16
Recovery of bank asset	10.78	0.72	7.53	0.45	7.53	0.44	7.53	0.45	(0.27)
C. Foreign Exchange Impact (A+B)	**33.40**	**2.24**	**15.42**	**0.92**	**24.83**	**1.45**	**24.25**	**1.45**	**(0.79)**

1) State Budget Calculation : realization period of January 1-December 31, 2001 (audited)
2) Revised State Budget (R) : estimated realization
3) Provisional Realization period of January 1-December 31, 2002 (revision IV, January 2003)
4) Difference between share of each post in 2002 State Budget to GDP with that of 2001 State Budget Calculation to GDP

Source : Ministry of Finance and Bank Indonesia (processed)

PROSPECTS FOR THE 2003 STATE BUDGET

In line with the mandate of the 2000 – 2004 National Development Program (Propenas), fiscal policy in the 2003 state budget will continue the process of fiscal consolidation that has been followed during the past two years. Operationally, this consolidation will be implemented by reducing the budget deficit through progressive increases in tax revenues, economizing spending (particularly on subsidies) and gradual reductions of offshore loans. Nonetheless, the government will make efforts to strengthen the fiscal stimulus through the reallocation of some funds from subsidies to development spending. Assumptions used in developing the 2003 state budget are presented in Table 7.8.

As a consequence of this approach to fiscal policy in 2003, the ratio of tax revenues to GDP is expected to rise, although the ratio of overall government revenues of GDP would drop slightly due to lower oil revenues. On spending, government efforts to hold down expenditures will be implemented through a significant reduction in subsidies. At the same time, more fiscal stimulus would be implemented through revenue and spending measures, including additional stimulus to speed up the recovery process and anticipate the negative impact of Bali tragedy[3] . On the overall, the budget deficit to GDP ratio in 2003 will be slightly higher (1.8%) as compared to that in 2002 (1.7%). To finance this deficit, the government will continue to depend in large part upon financing from the domestic non-banking sector and offshore loans. Remaining financing needs will be covered by drawdowns of some Rp8.5 trillion from government savings in the monetary system. This will be the first time that the government has taken this step since the 1997 economic crisis.

Table 7.8
Main Assumptions for The 2003 State Budget

Assumptions	Realization 2002[1)]	Budget 2003
Nominal GDP (trillions of rupiah)	1668	1940
Economic growth (%)	3.6	4.0
Inflation rate (%)	10.03	9.0
Crude oil price ($/barrel)	24.1	22.0
Oil production		
(millions of barrel per day)	1.26	1.27
Exchange rate (Rp/$)	9311	9000
Average three month SBI-rates (%)	15.2	13.0

1) Provisional Realization Period of January 1-December 31, 2002 (revision IV January 2003)

Source : Ministry of Finance

Government financial operations in 2003 will have several consequences, both on the aggregate demand and monetary sides of the economy. On the aggregate demand side, the direct contribution of the government sector to GDP will rise from the previous year, from 11.8% to 13.4%. This increase would be accounted for by both consumption and investment, which would increase from 7.0% to 7.7% of GDP and from 4.8% to 5.7% of GDP, respectively. These would be achieved through quite significant reductions in transfer payments, from 6.3% to 4.2% of GDP.

On the monetary side, rupiah additions to the economy are estimated to rise from 1.2% of GDP in 2002 to 1.4% in 2003. In nominal terms, they would rise from Rp19.5 trillion to Rp26.7 trillion. This additional rupiah liquidity in 2003 will be larger than government net foreign currency inflows in the same year, which are estimated to reach only 0.9% of GDP

3 The fiscal stimulus is in the form of delay, reduction, and revocation of 45 types of taxes (including income tax, sales tax and tax on luxurious goods) and civil servants' salary/pension increase of 10% on average. In addition, a Rp4.4 trillion social transfer payments are allocated for community/social programs to help those affected by fuel-energy subsidy reductions in the form of cheap rice, health care, education, clean water supply, funding small scale businesses, and opening of labour intensive projects.

(equivalent to Rp18.2 trillion). The shortfall of foreign currency inflows relative to rupiah operations, in the amount of Rp8.5 trillion, represents the amount of the government's financial operations in rupiah that will not be offset by official net foreign currency inflows.

Government Revenues and Grants

Government revenues are planned to reach Rp336.2 trillion in 2003 or equivalent to 17.3% of GDP, slightly lower than in 2002 (18.0%). The dominant factor in this outcome would be lower non-tax revenues, particularly oil; the ratio of tax revenues would increase (Graph 7.6 and Table 7.9).

Viewed by type of revenues, revenues will continue to be dominated by non-oil/gas income tax, value added tax, and non-tax revenue from oil, with shares of 31.6%, 24.0%, and 11.9%, respectively. The largest broad component of government revenues, tax revenues, is expected to reach Rp254.1 trillion or 75.6% of total government revenues. Relative to the 2002 revised state budget, the tax ratio would rise from 12.7% to 13.1% (Graph 7.7). To achieve the tax target, policy measures will include:

a. A rise in the income tax rate on profits from asset revaluations;

b. Imposition of income tax on capital gains from the transfer of rights on oil production from one oil company to another;

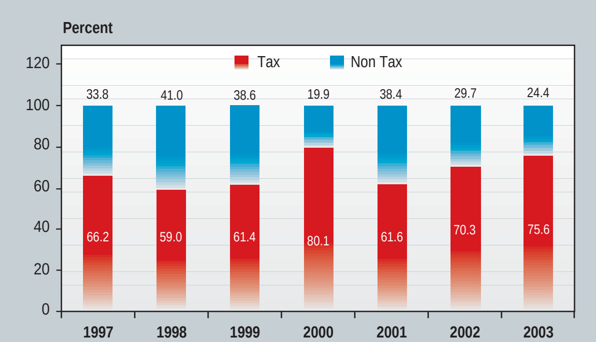
c. Revocation of the waiver on value added tax on strategic goods;

d. A rise in the percentage of taxable sales value in the land and buildings tax;

e. A change in the tax structure of the cigarette industry from three to two strata, namely small industry and non-small industry; and

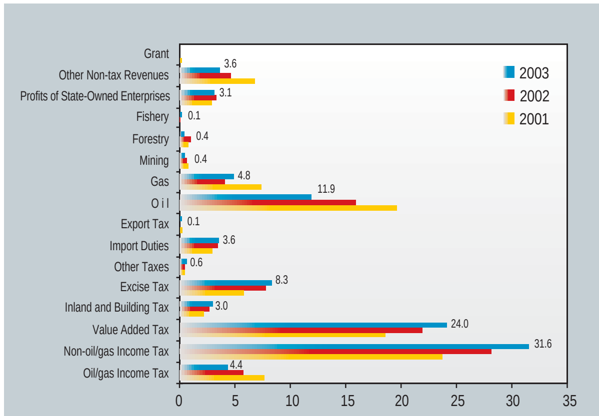
f. A change in the excise tax tariff from ad valorem to a semi-specific basis.

For their part, non-tax revenues are budgeted to reach Rp82.0 trillion or 24.4% of total government revenues. Relative to the 2002-revised state budget, non-tax revenues will drop from 5.3% to 4.2% of GDP. This drop would be attributable to lower revenues from natural resources (Graph 7.7). The drop in non-tax revenues from natural resources would be in line with the assumptions of a lower oil price and some appreciation of the rupiah.



Notes:
1) Data is processed from fiscal year to calendar year
2) 1997-2001 State Budget Calculation (SBC); 2002 Provisional ralization (unaudited) period of January 1- December 31, 2002 (revision IV-January 2003)

Graph 7.6
Development of Tax Revenues and Non-Tax Revenues (% of Government Revenues)



Graph 7.7
Components of Government Revenues

Government Expenditures

Government expenditures are budgeted to reach Rp370.6 trillion, which is equivalent to 19.1% of GDP and lower than the year before when it reached 19.7% of GDP (Table 7.10). This drop originates in a lower ratio of central government routine expenditures to GDP; central government development expenditures and regional budget expenditures will increase slightly. This policy is part of the fiscal consolidation steps adopted by the government in order to ensure fiscal sustainability.

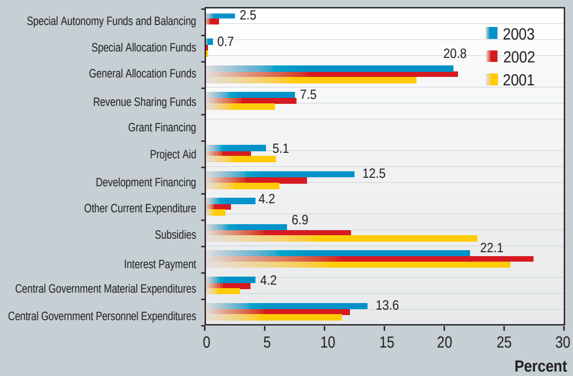
Routine expenditures are planned to reach Rp188.6 trillion or 50.9% of total government expenditures. This is down from 11.3% of GDP in 2002 to 9.7% of GDP in 2003 (Graph 7.8). The decline in routine expenditures would be mainly due to lower fuel subsidies and interest payments, both on domestic and offshore loans. The decline in fuel subsidies would stem from adjustments to domestic fuel prices and from an assumed appreciation of the rupiah from Rp9,316 to

(Trillions of Rp)

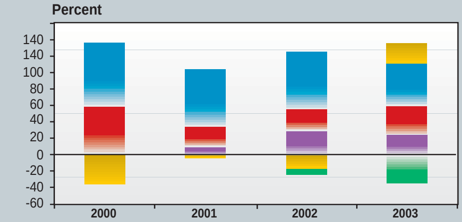
Table 7.9
Projected Government Revenues and Grants

Item	2002 Realization[1]		2003 Budget		
	Nominal	%of GDP	Nominal	%of GDP	Change[2]
A. Government Revenues and Grants	**300.19**	**18.00**	**336.16**	**17.33**	**(0.67)**
I. Domestic Revenues	**299.89**	**17.98**	**336.16**	**17.33**	**(0.65)**
1. Tax revenues	**210.95**	**12.65**	**254.14**	**13.10**	**0.45**
a. Domestic taxes	200.32	12.01	241.74	12.46	0.45
i. Income tax	101.68	6.10	120.92	6.23	0.14
1. Oil and gas	17.22	1.03	14.78	0.76	(0.27)
2. Non-oil and gas	84.46	5.06	106.15	5.47	0.41
ii. Value added tax	65.85	3.95	80.79	4.16	0.22
iii. Land and building tax	6.36	0.38	7.52	0.39	0.01
iv. Excise on land and building transfer	1.63	0.10	2.40	0.12	0.03
v. Excise tax	23.34	1.40	27.95	1.44	0.04
vi. Other taxes	1.47	0.09	2.16	0.11	0.02
b. International trade tax	10.63	0.64	12.40	0.64	0.00
i. Import duties	10.40	0.62	11.96	0.62	(0.01)
ii. Export tax	0.23	0.01	0.44	0.02	0.01
2. Non-tax Revenues	**88.93**	**5.33**	**82.02**	**4.23**	**(1.10)**
a. Natural resource revenues	65.22	3.91	59.40	3.06	(0.85)
i. Oil	47.69	2.86	39.91	2.06	(0.80)
ii. Gas	12.33	0.74	16.28	0.84	0.10
iii. Mining	1.85	0.11	1.48	0.08	(0.03)
iv. Forestry	3.15	0.19	1.27	0.07	(0.12)
v. Fishery	0.20	0.01	0.45	0.02	0.01
b. Profit transfer from State-owned Enterprises (SOEs)	9.76	0.59	10.41	0.54	(0.05)
c. Other non-tax revenues	13.95	0.84	12.21	0.63	(0.21)
II. Grants	**0.30**	**0.02**	**-**	**-**	**(0.02)**

1) Provisional realization (unaudited) period of January 1-Desember 31, 2002 (revision IV, January 2003)
2) Difference between share of each post in 2003 State Budget to GDP with that of 2002 State Budget realization to GDP
Source : Ministry of Finance and Bank Indonesia (processed)



Graph 7.8
Components of Government Expenditures



	2000	2001	2002	2003
Sell (+)/Buy (-) SUN	0.0	0.0	-7.0	-35.0
UBF (+= contr; - = exp)	-36.1	-3.0	-17.0	24.7
I B R A	78.1	69.1	70.6	52.3
Net off-shore loans	57.8	25.4	25.7	34.8
Privatization	0.1	8.6	27.7	23.2

UBF = Unused Budgetary Funds, (contr = contraction, exp = expansion)

Notes:
2000-2001 State Budget Calculation; 2002 provisional realization (unaudited), period of January 1-December 31, 2002 (revision IV-January 2003); 2003 State Budget

Graph 7.9
Components of Deficit Financing

Rp9,000.[4] Lower interest payments on domestic loans are based upon an expected decline in the 3-month SBI rate from 15.2% in 2002 to 13.0% in 2003. Also outstanding amounts of bonds would drop due to maturing issues and the policy on government buybacks.

Regional budget expenditures represent another large portion of budgeted expenditures in 2003, namely Rp116.9 trillion or 31.5% of total government spending. Relative to the 2002-revised state budget, this figure is slightly up from 5.9% to 6.0% of GDP.

The smallest allocation of funds is for development expenditures, which are planned at Rp65.1 trillion or 17.6% of total government expenditures. As already mentioned above, this figure is sharply higher than in 2002, from 2.4% to 3.4% of GDP, in an effort to raise fiscal stimulus and to offset negative effects of the Bali incident.

4 Retail fuel prices in 2002 have generally been set at 75.0% of market prices (or 25.0% subsidized). In 2003, prices of all types of fuel, except for kerosene for household consumption and small-to-medium scale industries will be set at 100% of Singapore market price (Mid Oil Platts Singapore) plus 5%.

Deficit and Financing

The deficit for the 2003-state budget is estimated to be Rp34.4 trillion or 1.8% of GDP. This figure is a bit higher than the deficit in the 2002-revised state budget, which is estimated at 1.7% of GDP. To finance this deficit, the government would continue to depend on domestic non-bank sources, mainly IBRA asset sales and privatisation.

Asset sales and privatisation are planned to reach Rp18 trillion and Rp8 trillion, respectively.[5] Also, some Rp12.1 trillion is budgeted into the domestic non-bank account for the financing of Government Securities management, of which Rp8.5 trillion is planned to come from accumulated savings from previous budget (known as SAL / Sisa Anggaran Lebih) for the purpose of financing the government bond buyback program.

Meanwhile, the government is planning to drawdown offshore loans equivalent to Rp29.3 trillion; amortization of offshore loans is equivalent to Rp17.3 trillion. This takes into account principal and interest rescheduling on offshore loans resulting from the Paris

5 The 2003 privatization program covers the unfinished parts of the 2002 program and adds sales of some other state-owned enterprises.

(Trillions of Rp)

Table 7.10
Projected Government Expenditures

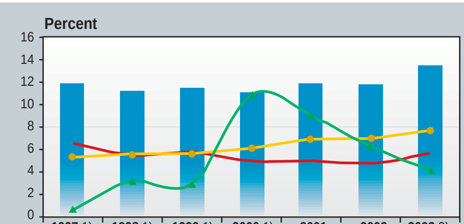
Item	2002 Realization Nominal	2002 Realization % of GDP[1)]	2003 Budget Nominal	2003 Budget % of GDP	2003 Budget Change[2)]
B. Government Expenditures	**327.86**	**19.66**	**370.59**	**19.10**	**(0.55)**
I. Central Government Expenditures	**229.34**	**13.75**	**253.71**	**13.08**	**(0.67)**
1. Routine Expenditures	**189.07**	**11.34**	**188.58**	**9.72**	**(1.61)**
a. Personnel expenditures	39.69	2.38	50.24	2.59	0.21
b. Material expenditures	12.43	0.75	15.43	0.80	0.05
c. Interest Payment	89.87	5.39	81.98	4.23	(1.16)
i. Domestic interest	64.46	3.86	55.18	2.84	(1.02)
ii. Foreign interest	25.41	1.52	26.80	1.38	(0.14)
d. Subsidies	40.01	2.40	25.47	1.31	(1.09)
i. Oil subsidies	31.16	1.87	13.21	0.68	(1.19)
ii. Non-oil subsidies	8.84	0.53	12.26	0.63	0.10
- Rice (BULOG)	-	-	4.70	0.24	0.24
- Electricity	-	-	4.52	0.23	0.23
- Credit program	-	-	1.64	0.08	0.08
- Others	-	-	1.40	0.07	0.07
e. Other eoutine expenditures	7.08	0.42	15.48	0.80	0.37
2. Development expenditures and net lending	**40.27**	**2.41**	**65.13**	**3.36**	**0.94**
a. Rupiah financing	27.64	1.66	46.23	2.38	0.73
b. Project aid (incl. Grants)	12.63	0.76	18.90	0.97	0.22
II. Regional Budget Expenditures	**98.52**	**5.91**	**116.88**	**6.02**	**0.12**
1. Balance budget	**94.76**	**5.68**	**107.49**	**5.54**	**(0.14)**
a. Revenue sharing funds	24.99	1.50	27.90	1.44	(0.06)
b. General allocation funds	69.14	4.15	76.98	3.97	(0.18)
c. Special allocation funds	0.64	0.04	2.62	0.13	0.10
2. Special autonomy	**3.76**	**0.23**	**9.39**	**0.48**	**0.26**

1) Provisional realization (unaudited) period of January 1-Desember 31, 2002 (revision IV, January 2003)
2) Difference between share of each post in 2003 State Budget to GDP with that of 2002 State Budget realization to GDP
Source : Ministry of Finance and Bank Indonesia (processed)

Club III. Total net financing from offshore and domestic non-back sources would be insufficient to cover the deficit. Consequently, the government is planning to drawdown some Rp8.5 trillion from its savings in the monetary system (Table 7.11).

Impact of Government Financial Operations On Aggregate Demand, Monetary Conditions, and the Balance of Payments

Concerning aggregate demand, the direct contribution of the government to GDP is to rise



	1997 1)	1998 1)	1999 1)	2000 1)	2001	2002	2003 2)
Govt. Expenditure	11.9	11.2	11.5	11.1	11.9	11.8	13.4
Consumption	5.4	5.7	5.7	6.1	6.9	7.0	7.7
Investment	6.5	5.5	5.8	5.0	5.0	4.8	5.7
Transfer Payment 3)	0.7	3.2	3.0	10.9	9.1	6.3	4.2

Notes:
1) Data is processed from fiscal year to calendar year
2) 1997-2001 State Budget Calculation (SBC); 2002 Provisional ralization (unaudited) period of January 1- December 31, 2002 (revision IV-January 2003)
3) Consist of Interest Payments Domestic Debt and Subsidies

Graph 7.10
Prospect for Impact of Government Financial Operations on The Real Sector
(% of GDP based on Current Prices)

(Trillions Rp)

Table 7.11
Projected Government Financial Operations

Item	2002 Realization 1)		2003 Budget		
	Nominal	% of GDP	Nominal	% of GDP	Change2)
A. Government Revenues and Grants	**300.19**	**18.00**	**336.16**	**17.33**	**(0.67)**
I. Domestic Revenues	**299.89**	**17.98**	**336.16**	**17.33**	**(0.65)**
1. Tax Revenues	**210.95**	**12.65**	**254.14**	**13.10**	**0.45**
2. Non Tax Revenues	**88.93**	**5.33**	**82.02**	**4.23**	**(1.10)**
II. Grants	**0.30**	**0.02**	**-**	**-**	**(0.02)**
B. Goverment Expenditures	**327.86**	**19.66**	**370.59**	**19.10**	**(0.55)**
I. Central Government Expenditures	**229.34**	**13.75**	**253.71**	**13.08**	**(0.67)**
1. Routine Expenditures	**189.07**	**11.34**	**188.58**	**9.72**	**(1.61)**
2. Development Expenditures	**40.27**	**2.41**	**65.13**	**3.36**	**0.94**
II. Regional Budget Expenditures	**98.52**	**5.91**	**116.88**	**6.02**	**0.12**
1. Balance Budget	**94.76**	**5.68**	**107.49**	**5.54**	**(0.14)**
2. Special Autonomy	**3.76**	**0.23**	**9.39**	**0.48**	**0.26**
C. Primary Balance	**62.19**	**3.73**	**47.54**	**2.45**	**(1.28)**
Statistical Discrepancy	**(0.00)**		**(0.00)**		
D. Overall Balance	**(27.68)**	**(1.66)**	**(34.44)**	**(1.78)**	**(0.12)**
E. Financing	**27.68**	**1.66**	**34.44**	**1.78**	**0.12**
I. Domestic Financing	**20.56**	**1.23**	**22.45**	**1.16**	**(0.08)**
1. Domestic banks	**(4.71)**	**(0.28)**	**8.50**	**0.44**	**0.72**
a. Monetary authority	(4.71)	(0.28)	8.50	0.44	0.72
b. Credit/loans of banking sector	-	-	-	-	-
c. Monetary correction	-	-	-	-	-
2. Non-domestic banks	**25.27**	**1.52**	**13.95**	**0.72**	**(0.80)**
a. Privatization proceeds	7.66	0.46	8.00	0.41	(0.05)
b. Recovery of bank asset	19.55	1.17	18.00	0.93	(0.24)
c. Government bonds	(1.94)	(0.12)	(12.05)	(0.62)	(0.50)
II. Foreign Financing (Net)	**7.12**	**0.43**	**11.99**	**0.62**	**0.19**
1. Gross Drawing	**19.37**	**1.16**	**29.25**	**1.51**	**0.35**
a. Program Aid	7.04	0.42	10.35	0.53	0.11
b. Project Aid	12.33	0.74	18.90	0.97	0.23
2. Amortization	**(12.26)**	**(0.73)**	**(17.26)**	**(0.89)**	**(0.15)**

1) Provisional realization (unaudited) period of January 1-Desember 31, 2002 (revision IV, January 2003)
2) Difference between share of each post in 2003 State Budget to GDP with that of 2002 State Budget realization to GDP
Source : Ministry of Finance and Bank Indonesia (processed)

relative to the previous year, from 11.8% to 13.4%. This would stem from both higher consumption (from 7.0% to 7.7%) and investment (4.8% to 5.7%) spending. By contrast, there would be a significant cut in transfer payments, from 6.3% to 4.2% (Graph 7.10).

Meanwhile, the shares of consumption and investment spending in total government expenditures, will be roughly unchanged at around 65.0% and 35.0%, respectively. The bulk of consumption expenditures is still allocated for general allocation funds and central government employee expenditures; the major part of investment spending is still allocated for rupiah financing and shared revenue funds.

Transfers to the private sector would drop from 6.3% of GDP in 2002 to 4.2% in 2003. A quite significant drop in fuel subsidies is a consequence of the shift in government spending priorities to development expenditures for the purposes of fiscal stimulus. There also will be a decline in interest payments on domestic loans due to assumed declines in interest rate and lower outstanding domestic loans (Table 7.12).

On the monetary side, rupiah liquidity injected by government operations into the economy in 2003 would increase from the previous year, from Rp19.5 trillion to Rp26.7 trillion. The largest rupiah expansion would originate in payments of balancing funds to the regions, which would reach 36.0% of total government rupiah expenditures. Interest payments on domestic loans, investment expenditures, and central government employee expenditures would also make sizable contributions, of around 15.0%-17.0% each. Meanwhile, rupiah contraction would mostly (85.0%) originate in tax revenues, particularly non-oil/gas income tax and value added tax (Table 7.13).

On government foreign currency transactions, inflows would be accounted for by oil and gas revenues and drawdowns of offshore loans. This amount would exceed servicing of government offshore liabilities and imports under aid projects. Consequently, the government would generate net foreign currency inflows for Indonesia's balance of payments in an amount equivalent of Rp18.2 trillion (Table 7.14).

Looking at the overall impact, the government's net foreign currency inflows will fall short of its net rupiah expansion. Consequently not all of the government's net rupiah expansion can be offset (sterilized) by its net foreign currency inflows. This is in line with government's plan to utilize SAL in the amount of Rp8.5 trillion in order to cover its budgetary financing gap in 2003.

(Trillions of Rp)

Table 7.12
Projected Fiscal Stimulus

Item	2002 Realization[1]		2003 Budget		
	Nominal	% of GDP	Nominal	% of GDP	Change[2]
I. Government Consumptions	**117.06**	**7.02**	**149.70**	**7.72**	**0.70**
Domestic personnel expenditures	38.79	2.33	48.70	2.51	0.18
Domestic material expenditures	11.84	0.71	14.24	0.73	0.02
General allocation funds	55.60	3.33	61.90	3.19	(0.14)
Special autonomy funds and balancing	3.76	0.23	9.39	0.48	0.26
Other routine expenditures	7.08	0.42	15.48	0.80	0.37
II. Gross Domestic Fixed Capital Formations	**79.44**	**4.76**	**110.72**	**5.71**	**0.94**
Rupiah financing	27.64	1.66	46.23	2.38	0.73
Project aid	12.63	0.76	18.90	0.97	0.22
General allocation funds	13.54	0.81	15.07	0.78	(0.03)
Revenue sharing and special allocation funds	25.63	1.54	30.51	1.57	0.04
III. Total I + II	**196.49**	**11.78**	**260.42**	**13.42**	**1.64**
Memo Items : Transfer Payments	104.47	6.26	80.65	4.16	(2.11)
a. Domestic interest	64.46	3.86	55.18	2.84	(1.02)
b. Subsidies	40.01	2.40	25.47	1.31	(1.09)

1) Provisional realization (unaudited) period of January 1-Desember 31, 2002 (revision IV, January 2003)
2) Difference between share of each post in 2003 State Budget to GDP with that of 2002 State Budget realization to GDP
Source : Ministry of Finance and Bank Indonesia (processed)

(Trillions of Rp)

Table 7.13
Projected Rupiah Impact of Government Financial Operations

Item	2002 Realization[1] Nominal	2002 Realization[1] % of GDP	2003 Budget Nominal	2003 Budget % of GDP	2003 Budget Change[2]
A. Revenues in Rupiah					
Taxes					
Oil and gas	17.22	1.03	14.78	0.76	(0.27)
Non-oil and gas	191.46	11.48	239.36	12.34	0.86
Non-taxes	50.38	3.02	43.78	2.26	(0.76)
Privatization	2.19	0.13	2.29	0.12	(0.01)
Recovery of bank asset	12.02	0.72	11.06	0.57	(0.15)
Government bonds	(1.94)	(0.12)	(12.05)	(0.62)	(0.50)
Total revenues	**271.32**	**16.27**	**299.22**	**15.42**	**(0.84)**
B. Expenditures in Rupiah					
Operational	(162.17)	(9.72)	(159.06)	(8.20)	1.52
Personnel expenditure	(38.79)	(2.33)	(48.70)	(2.51)	(0.18)
Subsidies	(40.01)	(2.40)	(25.47)	(1.31)	1.09
Domestic interest payments	(64.46)	(3.86)	(55.18)	(2.84)	1.02
Other routine expenditure	(18.91)	(1.13)	(29.71)	(1.53)	(0.40)
Investment	(30.17)	(1.81)	(50.01)	(2.58)	(0.77)
Balance budget	(98.52)	(5.91)	(116.88)	(6.02)	(0.12)
Total expenditures	**(290.86)**	**(17.44)**	**(325.95)**	**(16.80)**	**0.64**
C. Statistical Discrepancy	**(0.00)**		**(0.00)**		
D. Rupiah Impact	**(19.54)**	**(1.17)**	**(26.73)**	**(1.38)**	**(0.21)**

1) Provisional realization (unaudited) period of January 1-Desember 31, 2002 (revision IV, January 2003)
2) Difference between share of each post in 2003 State Budget to GDP with that of 2002 State Budget realization to GDP

Source : Ministry of Finance and Bank Indonesia (processed)

(Trillions of Rp)

Table 7.14
Projected Foreign Currency Impact of Government Financial Operations

Item	2002 Realization[1] Nominal	2002 Realization[1] % of GDP	2003 Budget Nominal	2003 Budget % of GDP	2003 Budget Change[3]
A. Current Account	**4.13**	**0.25**	**(6.41)**	**(0.33)**	**(0.58)**
Trade balance	28.45	1.71	23.12	1.19	(0.51)
Oil and gas export	38.55	2.31	38.24	1.97	(0.34)
Project aid import	(10.11)	(0.61)	(15.12)	(0.78)	(0.17)
Services account	(24.32)	(1.46)	(29.53)	(1.52)	(0.06)
Foreign debt interest payment	(25.41)	(1.52)	(26.80)	(1.38)	0.14
Foreign personnel expenditure	(0.90)	(0.05)	(1.54)	(0.08)	(0.03)
Foreign material expenditure	(0.60)	(0.04)	(1.19)	(0.06)	(0.03)
Non-oil/gas income tax	2.28	0.14	-	-	(0.14)
Grants	0.30	0.02	-	-	(0.02)
B. Net Official Capital Inflows	**20.12**	**1.21**	**24.64**	**1.27**	**0.06**
Foreign debt disbursment	19.37	1.16	29.25	1.51	0.35
Foreign debt amortization	(12.26)	(0.73)	(17.26)	(0.89)	(0.15)
Privatization proceeds	5.48	0.33	5.71	0.29	(0.03)
Recovery of bank asset	7.53	0.45	6.94	0.36	(0.09)
C. Foreign Exchange Impact (A+B)	**24.25**	**1.45**	**18.23**	**0.94**	**(0.51)**

1) Provisional realization (unaudited) period of January 1-Desember 31, 2002 (revision IV, January 2003)
2) Difference between share of each post in 2003 State Budget to GDP with that of 2002 State Budget realization to GDP

Source : Ministry of Finance and Bank Indonesia (processed)

box

Reprofiling of Government Bonds

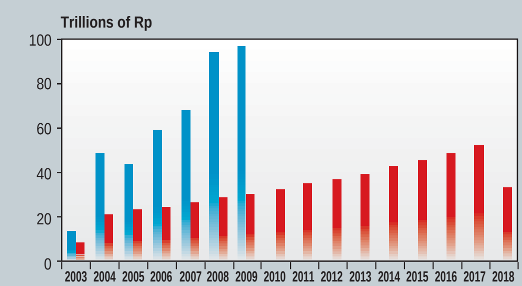
The policy to reprofile government bonds is an effort by the government to reduce future fiscal pressure. The government bond reprofiling program is undertaken by exchanging certain government bonds owned by recapitalized banks for a new series of government bonds with longer maturities. The government bond exchange noted above was based on the free of payment (FoP) principle, which means that there was no transfer of funds on the debt principal. The policy has voluntary characteristics and is directed at banks that have been recapitalized by the government.

More specifically, several considerations motivated the reprofiling policy, including: (i) the existing bond maturity structure is not evenly spread out over the future, with most bonds maturing in 2004 - 2009; (ii) a large government budget allocation for interest payments on government bonds, which limits the room for the government to provide fiscal stimulus; (iii) the secondary market for bonds is still underdeveloped, in the sense that there are only certain government bonds that are attractive in the market. Consequently, the market does not have a benchmark for transparent price formation.

For the government, the benefits of reprofiling include: (i) spreading out bond maturities over a longer period of time, thereby reducing the repayment cost of government bonds falling due in 2004 to 2009; (ii) reduced risk concerning inability to repay bond principal in the period of 2004-2009; (iii) the budget available for development expenditure rises because the budget for repayment of maturing bonds falls; (iv) to promote a benchmark yield curve that includes long-term maturities; and (v) lower refinancing risk, which would enhance market confidence in the issuance of government bonds.[1] From the side of recapitalized banks, this reprofiling program is also useful since it reduces the credit risk of those bonds. In addition, it could balance cash flow between that originating in those government bonds and banks' liquidity needs.

In implementing the reprofiling program, the government follows several principles, namely:

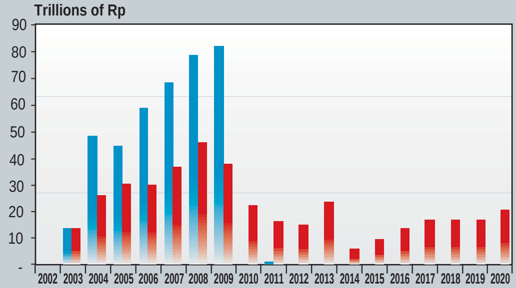
1 Other government efforts to reduce its outstanding stock of bonds include: repurchases, in the amount of Rp7.8 trillion, due to excess government capital participation; asset-for-bond swaps that reached Rp8.7 trillion; and redemptions of matured government bonds amounting to Rp3.9 trillion.



	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Govt. Bonds	13.5	48.7	44.7	59.0	68.1	94.3	96.9	-	0.9							
Govt. Securities	8.2	21.5	23.2	24.9	26.6	28.5	30.5	32.6	34.9	37.3	39.3	42.8	45.7	48.9	52.3	32.9

Remark : Hedge Bonds are assumed to be roll overed in 2008-2009
Source : Government Bond Management Center- Ministry of Finance

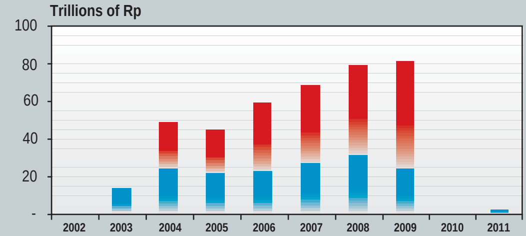
Government Bond Maturity Profile



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Before	-	13.5	48.7	44.7	59.0	68.1	79.0	81.6	-	0.9									
After		13.5	25.9	30.2	30.1	36.6	45.8	37.6	22.6	16.2	14.7	23.7	5.3	9.0	13.7	16.8	16.6	16.6	20.4

Remark : Excluding Government Bonds at Bank Indonesia and Hedge Bonds
Source : Government Bond Management Center- Ministry of Finance

Maturity Profile of All FR and VR-Series Government Bonds Before and After Reprofiling



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total	-	13.5	48.7	44.4	59.0	68.1	79.0	81.6	-	0.9
State-owned Banks			24.7	23.0	35.9	41.2	47.9	58.0	-	0.9
Others		13.5	24.0	21.4	23.1	26.9	31.2	23.6	-	

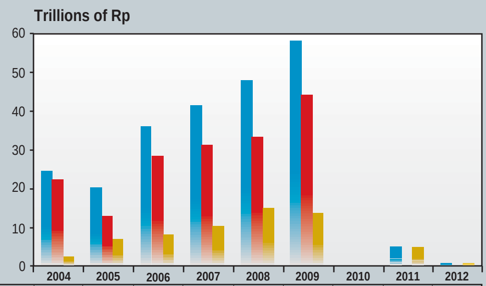
Remark : As of August 30, 2002, excluding Hedge Bonds dan Government Bonds at Bank Indonesia
Source : Government Bond Management Center- Ministry of Finance

Maturity Profile of Government Bonds By Ownership

(a) neutral or fixed Net Present Value (NPV), which means that the present value of new bonds under reprofiling is equal to that of the old bonds exchanged; (b) the maturity of bonds under reprofiling is extended through 2020 (maturities of the new FR series are 2010-2013, while maturities of the new VR series are 2014-2020); (c) use of the yield curve prevailing in the market, prevailing average bond prices in the secondary market, the movement of SBI interest rates, and an additional 2 bps (0.02%) per year after 2009; (d) the number of 2004-2009 bonds to be reprofiled is aligned to the projected capacity of the state budget, banking system liquidity needs and secondary market development.

For the first stage, the government bond-reprofiling program was conducted towards the four state banks namely Bank Mandiri, BNI, BRI and BTN, which was approved by the House of Representative on November 11, 2002 and was implemented on November 20, 2002. This is based on the consideration that state-owned banks constitute the largest ownership of government bonds. As regards the transfer of ownership, of the total amount of government bonds owned by the four state banks (Rp231.6 trillion), Rp171,8 trillion was returned to the government with maturities from 2004-2009, keeping the remaining balance of Rp59.8 trillion.

In more detail, bonds that were exchanged comprised those of the FR0002 to FR0009 series amounting to Rp74.8 trillion, and VR0006 to VR00016 series amounting to Rp97.0 trillion, taken from the four banks' investment portfolios and/or tradable portfolios. As replacements, the government issued new bonds with longer maturities, namely 2010 up to 2020, in equal nominal amounts. The new bonds are of the FR0010-FR0020 and VR0019-VR0031 series, and were registered in the respective banks' investment portfolios. Those bonds handed over to the government were deemed repaid and no longer valid as of November 20, 2002.



	2004	2005	2006	2007	2008	2009	2010	2011	2012
Ownership	24.3	19.9	35.9	41.3	47.9	57.6	-	4.5	0.3
Rearranged	22.1	12.9	28.2	31.2	33.2	44.1	-	0.0	0.0
Retained	2.2	7.0	7.7	10.1	14.7	13.5	-	4.5	0.3

Source : Government Bond Management Center- Ministry of Finance

Owned, Reprofiled, and Retained State Banks' Government Bonds

Of accrued interest on the Fixed Rate (FR) series bonds up to November 20, Rp2.9 trillion had been paid, while accrued interest on the Variable Rate (VR) series bonds will be calculated together with the payment for the first coupon of the new VR bonds and will be fully paid upon maturity of the next coupon.

The principle of a neutral NPV is predicted to add Rp0.8 trillion of interest per year (based on market yield curve as of September 13, 2002). However, this additional burden is expected to be covered by dividend and income tax from state-owned banks. To reach the dividend target, the government plans to raise the pay-out ratio of state-owned banks from 50.0% to 54.0% - 55.0%. In this context, profit is defined as state-owned banks' revenue after income tax.

Series and Maturity of Reprofiled Bonds

VR				FR			
Before Reprofiling		After Reprofiling		Before Reprofiling		After Reprofiling	
Series	Maturity	Series	Maturity	Series	Maturity	Series	Maturity
VR0006	25-Dec-04	VR0019	25-Dec-14	FR0006	15-Sep-04	FR0013	15-Sep-10
VR0007	25-Apr-05	VR0020	25-Apr-15	FR0007	15-Sep-04	FR0010	15-Mar-10
VR0008	25-Nov-05	VR0021	25-Nov-15	FR0003	15-May-05	FR0011	15-May-10
VR0009	25-Mar-06	VR0022	25-Mar-16	FR0008	15-May-05	FR0014	15-Nov-10
VR0010	25-Oct-06	VR0023	25-Oct-16	FR0009	15-May-05	FR0012	15-May-10
VR0011	25-Feb-07	VR0024	25-Feb-17	FR0004	15-Feb-06	FR0015	15-Feb-11
VR0012	25-Sep-07	VR0025	25-Sep-17	FR0005	15-Jul-07	FR0016	15-Aug-11
VR0013	25-Jan-08	VR0026	25-Jan-18	FR0002	15-Jun-09	FR0017	15-Jan-12
VR0014	25-Aug-08	VR0027	25-Jul-18			FR0018	15-Jul-12
VR0015	25-Dec-08	VR0028	25-Aug-18			VR0019	15-Jun-13
VR0016	25-Jul-09	VR0029	25-Aug-19			VR0020	15-Dec-13
VR0017	25-Jun-11	VR0030	25-Dec-19				
VR0018	25-Oct-12	VR0031	25-Jul-20				

Source : Government Bond Management Center- Ministry of Finance

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Act No. 24 Year 2002 on Government Securities

Act Number 24 Year 2002 on Government Securities (Surat Utang Negara/SUN) was put into effect on October 22, 2002. The main theme of this act is to ensure ‘standing appropriation’, namely a Government guarantee to the market on all debt repayments and interest payments arising from the issuance of Government Securities. The Act has two important purposes. First, to provide the legal basis for the Government to issue Government Securities. And second, to provide legal assurance for investors holding Government Securities, which would allow Government Securities to become a safe and risk-free investment instrument. As regards Bank Indonesia, the act also provides the legal basis for Bank Indonesia to act as an auction agent and administrator.

With reference to the Act on Government Securities, Government Securities comprise Government Treasury Notes (Surat Perbendaharaan Negara/SPN, which are similar to T-Bills in the US), and Government Bonds (Obligasi Negara/ON). Government Treasury Bills are Government Securities for maturities of up to 12-months with payment of interest on a discount basis. As such, these securities have similar characteristics to Bank Indonesia Certificates (SBI). Meanwhile, Government Bonds have longer than 12-months maturities with coupons and/or payments of interest on a discount basis.

Government Securities are issued with the following objectives: (i) to finance the state budgetary deficit; (ii) to cover short-term cash shortages due to mismatches in cash inflows and cash outflows in the Government Treasury account within one budget year; and (iii) to manage the Government debt portfolio.

ROLE OF THE GOVERNMENT, HOUSE OF REPRESENTATIVES, BANK INDONESIA AND THE CAPITAL MARKET SUPERVISORY AGENCY

a. Role of Government (Ministry of Finance)

The Act on Government Securities gives authority to the Government to issue and manage Government Securities (including related liabilities), with accountability and transparency. In implementation, this responsibility will be exercised through the Minister of Finance, who has established a special agency for handling the management of Government Securities, namely the Center for Government Bond Management (Pusat Manajemen Obligasi Negara/PMON).

As regards Government Securities’ management, the Minister of Finance is authorized among others to appoint auction agents in the primary market, including to set conditions pertinent to the auctions (methods, criteria for participation, and final decisions on the auctions), as well as parties that will operate the buying and selling of

Government Securities in the secondary market. In relation to accountability and transparency in the management of Government Securities, the Government is obligated to submit an accountability report to the House of Representatives (Article 16) as part of the implementation of the state budget and periodically to publish information concerning debt management policy, issuance plans, and the number and composition of Government Securities in circulation (Article 17).

b. Role of Bank Indonesia

The Act on Government Securities defines several roles for Bank Indonesia concerning the issuance of Government Securities. First, the Act on Government Securities obligates the Government to hold consultations with Bank Indonesia before issuance of Government Securities (Article 6) within a period of one fiscal year. The objective is to assess monetary implications due to the issuance of Government Securities in order to align fiscal policy (including debt management) and monetary policy.

Second, the act provides the legal basis for Bank Indonesia to act as Government Securities administrator (Article 12). As the administrator, Bank Indonesia undertakes three activities, namely: ownership registration; transaction clearing and settlement; and acting as paying agent of interest and principal on Government Securities. The first two activities concern Bank Indonesia's function as the central registry, while the third concerns Bank Indonesia's function as paying agent.

Third, the act provides the legal basis for Bank Indonesia to act as auction agent in the primary market (Article 13) for Government Treasury Notes. Meanwhile, as regards the issuance of Government Bonds, Bank Indonesia can be appointed by the government as the auction agent. The appointment of Bank Indonesia as the auction agent is expected to increase the effectiveness of monetary policy implementation and is consistent with Bank Indonesia's policy directions in using Government Securities as an alternative instrument for Open Market Operations, gradually replacing SBIs.

Fourth, the act can provide Bank Indonesia with the role of government agent in secondary market activities. In this regard, the government may appoint Bank Indonesia as buying or selling agent when the government undertakes the management of its debt in the secondary market (Article 14), for example, when the government buys back outstanding Government Securities.

c. Role of House of Representatives

As the legislative body with one task being to monitor the government, the House of Representative has a role before and after the issuance of Government Securities. Prior to the issuance of Government Securities, the government must first obtain House of Representatives' approval as stipulated in Article 7. This approval is important in providing standing appropriations, because it also covers approval of government obligations for interest and principal payments arising from the issuance of Government Securities up to maturity, by allocating funds from the state budget every year. After issuance of Government Securities, the House of Representatives could undertake its monitoring based upon the accountability report and publications submitted by the government as specified above.

d. Role of Capital Market Supervisory Agency

The Act on Government Securities also makes reference to the government role in regulating and supervising trading activities of Government Securities by functioning as capital market authority. This capital market authority is meant to be the Capital Market Supervisory Agency as regulated in Act Number 8 Year 1995 concerning Capital Markets. These regulating and supervising functions aim to give protection to investors and market players in Government Securities, as stipulated in Article 15. Regulating activities and supervision are needed in order for Government securities trading activities to be undertaken in an efficient and sound manner.

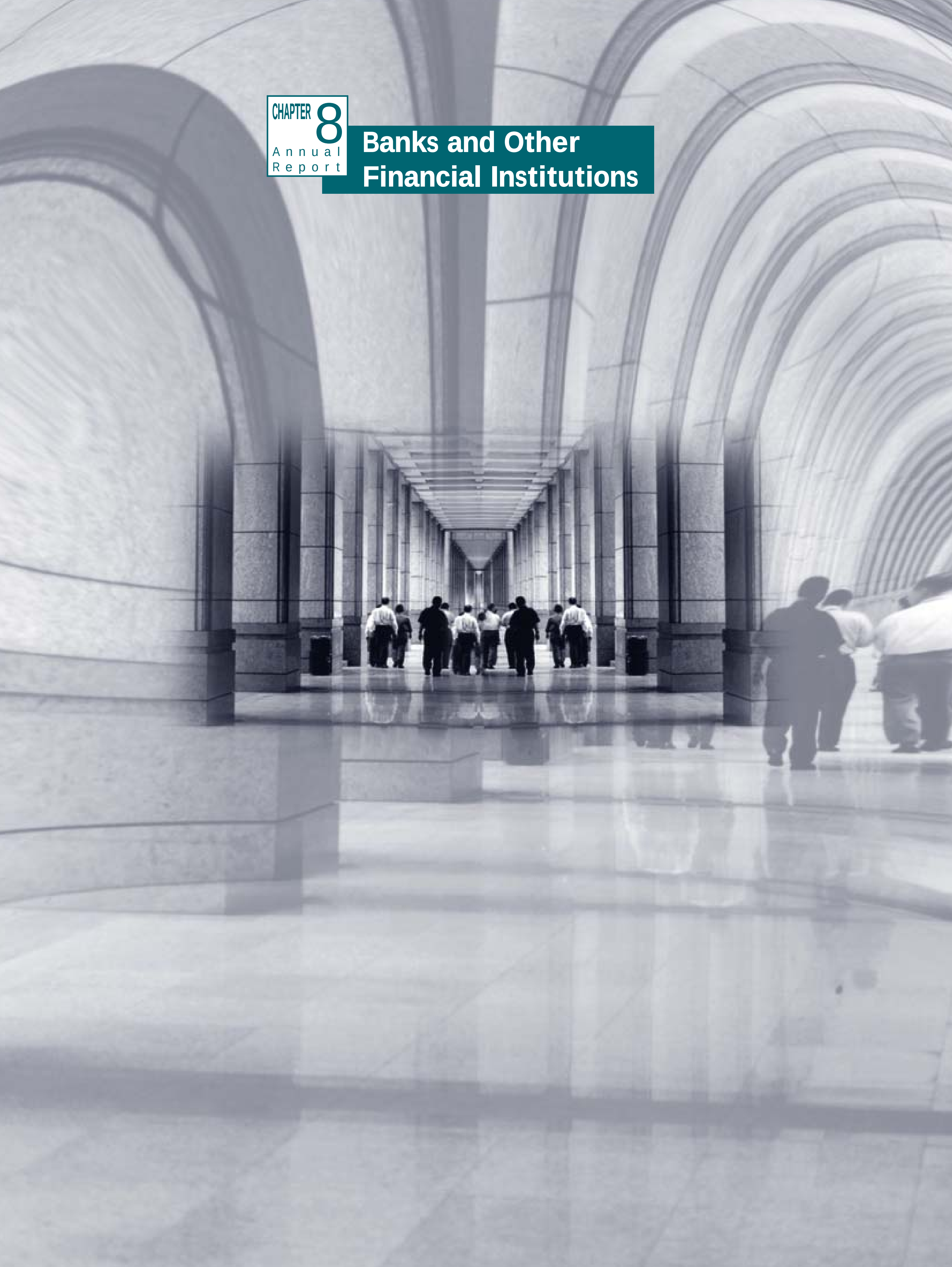
Legal Sanctions and Transfer Provision

To avoid forgery and illegal trading of Government Securities, the Act on Government Securities also determines firm sanctions on parties that deliberately break the law with administrative or criminal penalties as stipulated in Article 19. As regards the transfer provision, Article 20 determines that outstanding securities or bonds issued by the government before the Act comes into force, related to: (i) the commercial bank recapitalization program; (ii) offshore loans in the forms of bonds and other letters of indebtedness; (iii) domestic loans in the form of letters of indebtedness; and (iv) credit financing programs; are pronounced legal and are still valid until maturity.

CHAPTER 8

Annual Report

Banks and Other Financial Institutions



CHAPTER 8

BANKS AND OTHER FINANCIAL INSTITUTIONS

Various policies and stable monetary conditions have improved the performance of the banking sector as reflected in a recovery of intermediation, higher bank capital and improving quality of credit.

In general, performance of the banking sector and other financial institutions during 2002 has improved. In the banking sector, this was evidenced by ongoing recovery of the intermediation function, such as growing third-party funds and credit extensions. Improvement in the banking sector was also reflected by growing capital and profitability, as well as improving credit quality. Meanwhile, improved performance of other financial institutions, such as finance companies and the state-owned pawn company, was reflected in rising total assets, capital, value of business activities, as well as current-year profits. Improvements in the banking sector and other financial institutions were attributable to better macroeconomic conditions, such as a stable exchange rate, reduced inflation rate, and lower interest rates. In the banking sector, improvements were also prompted by banking policies issued by Bank Indonesia and internal consolidation among the banks.

However, recovery of bank intermediation still faced constraints, such as the banking sector's perception of higher risks and uncertainties in the real sector. This condition caused banks to be cautious in credit channeling, particular as regards credits to the corporate sector and long-term credits, and prompted them to undertake credit expansion into the small-to-medium enterprises. In this regards and in order to promote credits to the small-to-medium enterprises (SMEs), Bank Indonesia has simplified the evaluation criteria for the quality of credits extended by the banking sector to SMEs and to distressed areas. In addition, Bank Indonesia has also encouraged several banks with a sufficiently high Capital Adequacy Ratio (CAR) to focus more on their credit expansions in order to speed up recovery process of bank intermediation.

BANKING SECTOR

Continuing policies adopted in past years, during the reporting year, Bank Indonesia's banking policies remained focused on efforts to maintain the bank rehabilitation program and the banking system resilience program. Various banking policies supported by improvements in macro indicators have promoted improved performance in the banking sector during the reporting year. These improvements were reflected in growing third-party funds, increased capital and CAR, and improved NPLs ratio, as well as ongoing bank intermediation recovery. The recovery of the banks' intermediation function was reflected in growing new credit extensions, a rising LDR, changed composition of banks' earning assets, and rising revenue from credit channeling.

In the meantime, sharia banking during 2002 also experienced rapid growth, indicated by the increasing number of offices as well as the growth of assets, third-party funds, and financing extended. Favorable performance of sharia banking was related to the development of sharia money market as part of sharia banking infrastructures.

Favorable progress also occurred within the rural credit bank (Bank Perkreditan Rakyat/BPR) group, as reflected in the indicators for fund mobilization and channeling, as well as the NPLs ratio, profitability and capital.

Banking Policies

Banking policies remained focused on sustainable efforts for the implementation of the bank restructuring program, through: (1) the bank rehabilitation program, taking account of the government guarantee scheme covering commercial banks and BPR, commercial bank recapitalization, and bank credit restructuring; and (2) the strengthening of banking system resilience, covering banking infrastructure development, enhancement of good corporate governance, as well as enhancement of the banking sector's regulations and supervision system; (3) the bank intermediation recovery program, particularly through efforts in promoting credit channeling to the micro, small, and medium enterprises.

Bank Rehabilitation Program

During 2002, policies aimed at bank rehabilitation remained directed at continuing the government guarantee program. In addition, the monitoring of the commercial bank recapitalization program and the credit-restructuring program were also continued.

Guarantee Program

In order to maintain public confidence in the banking system, the government continued the guarantee program for commercial banks and BPR. As regards the guarantee program for commercial banks, gradual phasing out will be undertaken in line with the planned establishment of the deposit insurance institution (LPS-Lembaga Penjamin Simpanan). In this regard, Bank Indonesia, for and on behalf of the government, made payments for principal and interest on the interbank debt exchange offer. During the reporting period, payments made for obligations under the interbank debt exchange offer amounted to $171.7 million. As regards the BPR guarantee program, up to September 2002, total payments for customers' funds of the 96 BPR, for which business activities were frozen in 1999 and 2000, reached Rp115.3 billion. Meanwhile, guarantee payment for customers' funds of BPR, for which business activities were frozen in December 2001 and January 2002, have been approved.

Recapitalization Program

In implementing the recapitalization program, banks are obliged to register government bonds held in their investment, trade, and collateral portfolios. As of 31 December 2002, government bonds stood at Rp419.4 trillion, comprising Rp99.7 trillion (23.8%) in the trade portfolio and Rp319.6 trillion (76.2%) in the investment portfolio. The total amount of bonds in the trade portfolio went up Rp35.0 trillion (54.1%) relative the position at the end of 2001.

Viewed from the ownership side, Rp359.9 trillion (85.8%) was owned by recapitalized banks[1], while the remaining Rp59.5 trillion was owned by non-recapitalized banks, the public (sub registry) and the Ministry of Finance. Bonds owned by the public rose Rp31.8 trillion (244.5%), from Rp13.0 trillion at the end of 2001 to Rp44.8 trillion in December 2002. This stemmed in part from public interest in mutual funds, with government bonds as the underlying asset. With declining interest rates, these mutual funds were attractive to public due to higher returns than bank's deposit.

Credit Restructuring Program

With the expiration of the service period of the Debt Restructuring Task Force in Bank Indonesia on December 31, 2001, efforts related to the restructuring of problem credits included in banks' portfolios would still be made by the banks themselves, together with IBRA. Meanwhile, the Jakarta Initiative Task Force (JITF), continued to facilitate restructuring of offshore debts owned by non-bank private companies.

Out of a sample of 6 banks included in the list of Systemically Important Banks (SBIs), up to September 2002, credits restructured by those banks themselves reached Rp42.0 million. However, credit restructuring still encountered some problems, including (i) distressed condition of related companies, that have financed the payments of debtor's liabilities (ii) the low quality of borrowing companies' management; (iii) the restructuring requirements or models adopted by the banks at the start of the restructuring process sometimes were not in tune with the developments of the borrowers' businesses; (iv) agreed credit restructuring patterns were not completely followed by the borrowers; (v) difficulties in restructuring syndicated credits; (vi) problems concerning legal assurance in the execution of credit collateral, (vii) difficulties in settling borrowers' liabilities that were tied to borrowers (groups) at other banks and/or IBRA.

The restructuring of problem credits transferred by banks participating in the recapitalization program to IBRA, up to December 2002, reached Rp367.6 trillion for 296,883 borrowers, of which Rp55.9 trillion has entered the implementation stage of restructuring proposals and Rp21.4 trillion has been fully repaid.

Meanwhile, up to November 2002, offshore debts of non-bank private companies that have been settled through the mediation of the JITF reached $17.5 billion.

Strengthening Banking System Resilience

Efforts to strengthen banking system resilience were made through (i) bank infrastructure improvement as reflected in BPR and sharia banking developments as well as the planned establishment of LPS as the replacement of the government guarantee program; (ii) enhancement of the quality of bank management (good corporate governance) through the implementation of the fit and proper tests, the interviewing of prospective new bank managers, appointments of compliance directors, and submission of results of investigations into criminal offenses in the banking sector to the law-enforcement authorities; (iii) enhancement of various banking regulations; and (iv) strengthening of the banking

1 4 state banks, 4 taken-over banks, 3 national private commercial banks under recapitalization, and 12 regional development banks.

supervision system, with reference to the 25 Basel Core Principles for Effective and Risk-Based Banking Supervision.

Improvement in Banking Infrastructure

In order to promote a strong and resilient banking system and to maintain public confidence in the banking sector, sufficient banking infrastructure is needed, for example through the expansion of sharia banks and BPR,[2] as well as the planned establishment of the LPS.

The Government's current commitment to start reducing coverage of the government guarantee scheme and preparation for the establishment of the deposit insurance institution as stipulated in Article 37B of Act No.10 of 1998 will be discussed again in 2003. Through a very gradual and preannounced reduction in the coverage of the government guarantee scheme, the government will be able to effectively manage the stability and soundness of the banking sector in order to maintain public confidence. Several factors that should be taken into consideration in planning for a reduction in the coverage of the government blanket guarantee, are : (a) the economic conditions that are conducive to the bank rehabilitation process; (b) the completion of the bank restructuring process; (c) the availability of a framework of effective supervision and regulation; (d) the availability of procedures for settlement of problem banks; (e) the element of a lender of last resort; and (f) recovery of public confidence towards the banking sector.

2 For further clarification, please read the sub chapters on Sharia Banking Policy, BPR Policy, and Policy on Credits for the SMEs

In relation to preparation for the establishment of the LPS, the task force for LPS preparation, consisted of Bank Indonesia, the Ministry of Finance, and IBRA, are undertaking a review of the legal basis for the LPS's operations. One of the task force's recommendations is a proposal that the LPS is regulated under an act of law. An act of law will establish strong independence for the LPS and a stronger legal basis compared with the legal basis for the government guarantee scheme provided only by a government regulation. The plan for the establishment of the LPS will be tuned to government plans to start reducing the coverage of the government blanket guarantee.

Improved Good Corporate Governance on Banks

In general, efforts to enhance good corporate governance (GCG) in the banks have started in 1999 through the establishment of the National Policy Committee For Corporate Governance. The main task of this committee is to formulate and develop recommendations for national policies on corporate governance, covering guidelines on GCG, details on enhancement of legal instruments and the structure of institutional support. Specifically concerning the banking industry, GCG is undertaken through the fit and proper tests on bank owners and management, interviews with potential bank owners and management (new entries), appointments of compliance directors, and investigations into criminal practices in the banking sector.

Implementation of Fit and Proper Tests

Fit and proper tests are part of an effort to create human resources that have high integrity and competence in the banking sector. Evaluations are made of the board of commissioners, the board of directors, and executive officers that have been active in bank operations based upon Bank Indonesia's supervision and investigation units. From 1999 up to 2002, fit and proper tests have been applied to 1,149 persons comprising 93 owners/shareholders and 1,056 members of management.

Interviews with Potential Bank Owners and Management

Interviews are held with candidates for management, including heads of bank representative offices, and potential bank owners (new entrants) to identify their integrity and competence. During the reporting year, Bank Indonesia held interviews with 229 candidates comprising 12 potential owners and 217 management candidates proposed by 90 banks, of which 12 owner candidates (100%) and 197 management candidates (91%) passed.

Directors of Compliance

Directors of compliance are an important part of the internal control system implemented by a bank's management compliance units, take actions in preventing a bank's management from determining policies and/or making decisions containing elements of non-compliance, deviations or even violation against prudential principles and regulations. From July 1999 up to December 2002, banks have proposed 272 candidates, of whom 211 candidates were approved, 37 candidates were turned down, 5 candidates were still undergoing evaluation, and 19 candidates were withdrawn.

Investigation of Criminal Offenses in the Banking Sector

Bank Indonesia, the Indonesian National Police and Attorney General have intensified their coordination to handle cases of criminal offences in the banking sector. During 2002, Bank Indonesia has reported 28 allegations in 15 banks consisting of: (i) 9 cases concerning suspected transactions related to money laundering in 6 commercial banks; and (ii) 19 cases of suspected criminal offences in the banking sector in 7 commercial banks and 2 BPR.

In order to speed up follow ups of reports conveyed by banks on suspicious transactions, on December 1, 2002 Bank Indonesia set up an investigation team with the special task to analyze and follow up bank reports on suspicious transactions. However, with the recent establishment of The Center for Reporting and Analysis on Financial Transactions (Pusat Pelaporan dan Analisa Transaksi Keuangan/PPATK), the tasks of the investigation team is being transferred from Bank Indonesia to PPATK. Bank Indonesia fully supported government steps to immediately effectuate PPATK's operations by providing human resources and office facilities.

Enhancement of Bank Regulations

During the reporting year, Bank Indonesia has enhanced several regulations that covered the transfer of conventional commercial bank business activities into commercial banks based on the sharia principles, determination of interest margins on third-party savings guaranteed by the government, earning asset quality, and prudential principles in the purchase of credits by banks from IBRA.

In general, banking regulations issued by Bank Indonesia cover (i) the supervision system, (ii) prudential banking principles, and (iii) the government guarantee.

(i) Regulations issued within the scope of the supervision system included the determination on the status of BPR under special surveillance and a freeze on business activity,[3] transfer of conventional commercial bank business activities into commercial banks based on Sharia principles[4] and earning assets quality.[5] Regulation in the determination of the status of BPRs is the implementing regulation of Bank Indonesia Regulation (PBI) number 3/15/PBI/2001 dated 21 September 2001 on the Determination of the Status of BPR Under Special Surveillance and A Freeze on Business Activity, and its amendment in PBI No.3/24/PBI/2001 dated December 24, 2001. Meanwhile, regulation of earning asset quality has the objective of boosting increase the extension of credits to the small-scale enterprises (SMEs) and support the recovery of economic conditions in certain strife-turn areas and regions.

(ii) Regulations issued within the scope of prudential banking principles concern prudential principles for banks in purchasing credits from IBRA (Box : Limits For Purchases of Credits by Banks from IBRA).[6] The objective of this regulation is to ensure that banks follow prudential principles when purchasing credits from IBRA in order to avoid risks that could jeopardize national banking stability. In addition, with respect to the Bali tragedy, Bank Indonesia has issued a regulation on special treatment for commercial bank credits after the tragedy with the objective to support the recovery of economic conditions in Bali.[7]

(iii) Regulation that have been issued within the scope of the government guarantee cover determination of third-party saving interest margins.[8] The regulation among others states that interest margins on third-party funds guaranteed by the government in rupiah is determined at 200 basis points, while those in foreign currencies are determined at 100 basis points above the average interest rate of time deposits of member banks of the Jakarta Inter-bank Offered Rate (JIBOR) selected by Bank Indonesia.

Strengthening of Banking Supervision System

As in the previous year, the program for banking supervision strengthening still conformed to forward looking and risk-based supervision following the 25 Basel Core Principles (CP) for Effective Banking Supervision. Up to the end of 2002, Indonesia has been

3 SE No. 4/1/DPBPR dated January 24, 2002 on the Determination of the Status of BPRs under Special Surveillance and A Freeze on Business Activity

4 PBI No. 4/1/PBI/2002 dated March 27, 2002 on the Transfer of Conventional Commercial Activities into Commercial Banks based on Sharia Principles and Opening of Bank Office Based on Sharia Principles by Conventional Commercial Banks

5 PBI No. 4/6/PBI dated September 6, 2002 on the Amendment to Bank Indonesia Board of Governors Letter No. 31/147/KEP/DIR dated November 12, 1998 on Earning Assets Quality

6 PBI No.4/7/PBI/2002 dated September 27, 2002 on Prudential Principles For the Purchase of Credits by Banks from IBRA

7 PBI No.4/11/2002 dated December 20, 2002 on Special Treatment for Commercial Bank Credits After the Bali Tragedy

8 SE No.4/9/DPM dated June 26, 2002 on Determination of Interest Margin on Third-Party Funds Guaranteed by the Government

fully compliant with two principles, namely CP-1 Preconditions for Effective Banking Supervision, which covers Objectives, Independence and Resources, Legal Protection, and CP-2 Permissible Activities of Banks. Meanwhile there are 10 other principles on which Indonesia has achieved the status of largely compliant (Box : Master Plan for Enhancement of Bank Supervision Effectiveness)

Bank Supervision Policy

In strengthening bank supervision and enhancing bank regulation, Bank Indonesia refers to the 25 Basel Core Principles (BCPs), which formally have become the guideline for central banks and bank supervision institutions globally. Taking into account that most of the 25 BCPs have not been fulfilled, various efforts to step up bank supervision in Indonesia should be made.

In general the bank supervision system in Indonesia is still limited to the extent of compliance, while the internationally-adopted approach that brings more accurate results in reflecting bank conditions is the risk-based approach. In this respect, Bank Indonesia has developed and continued to enhance the framework of risk-based supervision. In principle, risk-based supervision is a monitoring and evaluation process that concerns the extent of the effectiveness of banks' risk and internal control system management implementation.

Risk-based supervision has many implications for Bank Indonesia and the banking sector. Bank Indonesia intends to convert its supervision framework from compliance approach to the risk-based approach. This risk-based supervision has been tried out in 2002 and its implementation will be continued in the years to come.

In addition, in line with more integration between domestic financial markets and global financial markets, and increased trading activities by banks, regulations on bank capital market risk are deemed necessary (Box: Regulation on Market Risk In Relation To Banks' Obligation To Provide Minimum Capital). This is consistent with the Basel Committee's 1996 document that recommends banks in allocating their capital in anticipation of losses due to changes in market prices. Bank Indonesia is in the process of preparing a regulation on the above subject and will issue the regulation sometimes in 2003.

Progress in Bank Supervision

In performing its task as the bank supervision authority, on August 20, 2002, Bank Indonesia changed the status of 2 national private commercial banks into Banks Under Special Surveillance due to their inabilities to meet the 8% CAR requirement. However, after both banks' management and shareholders took rehabilitation measures determined by Bank Indonesia, since October 9 and December 30, 2002, Bank Indonesia revoked their status as Banks Under Special Surveillance

In addition, Bank Indonesia has undertaken intensive supervision of banks that faced potential problems that could jeopardize the sustainability of their businesses based upon the following criteria: (i) having bank's rating of "Poor" or "Unsound"; (ii) having potential or actual problems in areas of liquidity, profitability and solvency based on overall risk assessment; (iii) having exceeded or violated maximum limits for credit extension and being unlikely to fulfill proposed settlement measures; (iv) having violated the limit for net open position and being unlikely to fulfill proposed settlement measures; (v) having minimum reserve requirements of more than 5.0%, but having basic liquidity problems; (vi) having basic profitability problems; (vii) having a net NPLs ratio of more than 5%; and (viii) posing a significant roles on systemic risk to the banking system and having a large influence on the national economy.

In addition, Bank Indonesia has carried out general investigations of 77 banks and special investigations on 54 banks. Special investigations carried out covered fit and proper tests, capital, earning asset quality, and implementation of Know Your Customer (KYC) principle. In order to improve bank capital structures, in September 2002 Bank Indonesia approved the merger of 5 banks (Bank Bali, Bank Universal, Bank Patriot, Bank Prima Express and Bank Artha Media) into Bank Permata Tbk.

Enhancement of Bank Intermediation

Against the corporate sector's low absorption ability, efforts to step up bank intermediation were made to prompt the banking sector to channel credits to the SMEs. Several efforts adopted by Bank Indonesia for the development of the micro, small and medium enterprises covered bank credit policies, institutional development, and provision of technical assistance.

Credit Policy For Micro, Small, and Medium Enterprises (UMKM/SMEs)

In order to empower and develop SMEs, a Memorandum of Understanding (MoU) or Joint Agreement has been signed on April 22, 2002 between the Coordinating Minister for People's Welfare and the Bank Indonesia Governor, on Poverty Alleviation through the Empowerment and Development of SMEs.

Accordingly Bank Indonesia has the tasks to: (a) stimulate commercial banks and BPR to step up their credit extensions to SMEs in accordance with the banks' business plans while yet be consistent with prudential principles; (b) monitor and evaluate extension of credits to SMEs by commercial banks and BPR every three months; (c) provide information on prime sector/sub-sector for the development of small businesses through the Integrated Information System for Small Business Development (SI-PUK); (d) conduct research; (e) hold training for staffs of commercial banks and BPR, particularly on the subject of financing of SMEs; (f) amend regulations on commercial banks and BPR to stimulate extension of credits to SMEs while yet be consistent with prudential principles and prevailing regulations; and (g) strengthen bank institutional infrastructure for extending credits to SMEs.

In addition to promoting credit channeling by banks to SMEs, Bank Indonesia also promoted funding for SMEs through the provision of KLBI (Bank Indonesia Liquidity Credit) Relending provided by the Coordinators of SOEs (BUMN Coordinators), as KLBI manager within the credit program. This was a follow up on Article 74 of Act 23 of 1999 that gives mandate for the transfer of KLBI management within the credit program to 3 state-banks as BUMN coordinators appointed by the government, namely Bank Rakyat Indonesia (BRI), Bank Tabungan Negara (BTN) and PT Permodalan Nasional Madani (PNM). The three BUMN coordinators are authorized to re-lend the repaid installments of KLBI received from the executing banks up to the time the repaid KLBI come to maturity. As of end 2002, the total repayments of KLBI relent by the BUMN coordinators to SMEs amounted to Rp3.6 trillion, up by 140% compared with Rp1.5 trillion at end of the past year. KLBI repayments that have been re-channeled amounted to Rp1.7 trillion or 48.6% of total repayments available. Compared with the position of re-channeled KLBI repayments as of end December 2001 of Rp1.3 trillion, there has been a rise of 30.8%. As was the case in the earlier year, re-channeling of funds was largely (76.5%) executed by PT PNM, in the amount of Rp1.3 trillion.

In addition to the re-lending funds, Bank Indonesia also supported funds provision for the credit program by the purchase of Government Securities (SUP) Number 005 with a ceiling of Rp9.97 trillion. Of total available funds at end of December of Rp3.09 trillion, Rp850 billion has been withdrawn by the government, leaving undisbursed funds at Rp2.24 trillion.

In addition, funding for SMEs as also supported by foreign funds in the form of two step loans (TSLs). According to Article 74 of Act 23 of 1999, the management of these funds should be transferred from Bank Indonesia to an SOEs. Meanwhile, based on the Minister of Finance Decree number 335/KM.1/2002 dated July 29, 2002, the Team for the Evaluation on the Extension of TSL, comprising two teams, namely the Steering Committee and Executing Committee. Bank Indonesia has been appointed as member of the Steering Committee, chaired by the Director General for Financial Institutions. The objective of establishing these teams is to undertake evaluation in the framework of giving recommendations for the financial institution that could manage TSLs that would be transferred from Bank Indonesia and after that would act as intermediary institution in new extensions of TSLs.

Institutional Development of SMEs

The program for the development of SMEs does not only cover credit policy area, but also its institutional development. In this respect, Bank Indonesia promoted a linkage program between commercial banks and BPR in extending credits to SMEs. Up to December 2002, 8 banks and PT NIM have formed cooperation with 727 BPR for a Rp310 billion credit ceiling. In addition, Bank Indonesia also promoted the establishment of Centers for Small and Medium Scale Businesses, which are institutions providing services from banks to SMEs. Up to now, four banks have set up service centers.

In addition, Bank Indonesia also held intermediation bazaars, among others in Makasar, Medan and Bandung, with the objective to link banks and SMEs (Box: Makassar Meeting and Efforts To Develop Small-To-Medium Enterprises).

The establishment of a credit bureau, an institution that compiles, processes, and provides information on individuals' creditworthiness, namely information on the individual's track record in fulfilling their financial obligations, was in the plan. Complete and comprehensive information will ease banks in the careful process and analysis of credit channeling according to the request of debtors/forthcoming debtors, thus reducing potential loss. Besides, in anticipation of debtors' malpractices, the role of credit insurance institution (PT Askrindo dan Perum Sarana Pengembangan Usaha) continued increasing.

Technical Assistance to SMEs

In an attempt to develop SMEs, Bank Indonesia continued to provide technical assistance to banks through training, research, and provision of information. During the year in review, the technical assistance coverage was expanded, including SMEs as well.

Throughout 2001, training held by Bank Indonesia included training for commercial banks, training of facilitators (ToF), training of trainers (ToT), workshop, exposure training program (ETP), and consultancy. Bank Indonesia has conducted research aimed at mapping the micro, small and medium scale sector potential through Baseline Economic Surveys (BLS) and research on financing models for the micro, small and medium scale sector.

Sharia Bank Policy

As an effort to create sound sharia banking that could meet public needs and contribute in promoting banking system resilience and national development, Bank Indonesia has undertaken several steps in line with its function and role as the banking authority. Since the start of sharia banking development, a number of important issues have been identified and need to have attention to ensure the achievement of the targets of sharia banking development, among which include : (i) preparation and enhancement of regulations and legislations in accordance with the characteristics of sharing banking; (ii) expansion of sharia banking office network, which could meet growing needs of the public; (iii) increase public understanding of sharia banking; (iv) provision of infrastructure and supporting institutions, which could promote development of sound and consistent (*istiqomah*) sharia banking practices in implementing sharia principles; (v) increased efficiency in the operation, service quality, and competitiveness of sharia banking; (vi) promotion of development of proportional profit sharing financing system in sharia bank financing portfolio; and (vii) realization of sharia banks that are competent, professional, and consistent with international standards.

During 2002, a number of initiatives and strategic steps were undertaken using a gradual approach that is sustainable and takes into consideration short-term urgency and priorities. Important steps undertaken during 2002 were (i) preparation of the Blue Print for Indonesia's Sharia Banking Development; (ii) improvement of regulations; (iii) increase of public understanding; and (iv) increase of international cooperation in sharia banking area for the development of supporting sharia banking infrastructures and institutions.

Blue Print for Sharia Banking Development

For the development of a sound and mandatable (*amanah)* sharia banking, as well as in anticipation of the challenges that will face Indonesia's sharia banking system, Bank Indonesia has prepared the "Blue Print for Sharia Banking Development in Indonesia", which is an integral part of the Indonesian Banking Architecture.

The blue print sets the position and view point of Bank Indonesia as regards the development of sharia banking in Indonesia and functions as a reference point for sharia banking stakeholders. Sharia banking philosophic view and achievement strategy are formulated into vision, mission, and targets as well as initiatives that will be undertaken within the next 10 years' period. The vision of sharia banking development is: "The creation of sharia banking system that is competitive, efficient, as well as fulfilling prudent principles and able to support the real sector in real sense through financing activities based on profit-sharing principle and real transactions, in the framework of equality, mutual assistance, kindness for the prosperity (*kemaslahatan*) of the people".

Realistic targets to accomplish the proclaimed vision have been set in consideration of actual conditions, as well as the strengths and weaknesses of players in the sharia banking industry and other stakeholders. The targets for sharia banking development up to year 2011 are categorized into 4 target focuses: (1) fulfillment of sharia principles in the activities of sharia banks; (2) adoption of prudent principles sharia banking operation; (3) creation of competitive and efficient sharia banking system; and (4) creation of systemic stability and realization of sharia banking benefits for the wide public. As regards the fourth focus, the target for national sharia banking growth is set to reach 5.0% of the total national banking assets in the year 2011.

In the efforts to reach the set targets, Bank Indonesia has determined strategic initiatives that put emphasis on aspects of the enhancement of sharia principles fulfillment, quality of prudent regulations, efficiency of operation and competitiveness, as well as stability of the banking system. Implementation of these strategic initiatives is divided into three stages. The first stage prioritizes initiatives into the laying down of a strong foundation for growth. The second stage focuses initiatives on efforts to strengthen the industry's structure. The third stage focuses initiatives on the fulfillment of international financial standards and service quality.

Preparation and Enhancement of Sharia Banking Legislations and Regulations

Efforts in the preparation and enhancement of legislations and regulations that are conforming to the characteristics of sharia banking business activities are key priorities in the creation of sound and consistent sharia banking system, in implementing sharia principles. Comprehensive legislations and regulations are needed as the basis for the development of national sharia banking.

Academic Paper for Draft of Law on Sharia Banking

During 2002, an academic paper has been developed with the objective of reviewing the urgency of enhancing legislations that regulate sharia banking, whether in the form of sharia banking law or as part of the law on banking. This review, undertaken with inputs from sharia banking practitioners, academicians, moslem religious leaders, and prominent public figures, resulted in conclusions and arguments concerning the benefits of sharia banking development and the need for a separate sharia banking law. Currently, the main outcomes of the review become inputs for the enhancement of sharia banking regulations within the banking law, with the consideration that sharia banking constitutes part of the national banking system.

Improvement of Institutional Regulations

In enhancing regulations concerning sharia banking institution, PBI No.4/1/PBI/2002 concerning conversion of conventional commercial bank business activities into commercial banks operating under the sharia principles, and the opening of commercial bank offices operating under the sharia principles by conventional commercial banks came into force on 27 March 2002. The regulation has the objective to enhance and clarify stipulations that regulate full conversion of conventional bank business activities into sharia banks, as well as the undertaking of sharia banking business activities by conventional commercial banks. In addition, this regulation also gives wider alternatives concerning the development of sharia banking service office network, by allowing conventional banks that already have sharia business units to open sharia bank office network in their conventional bank offices. The sharia bank offices within the conventional banks' offices are further called sharia units.[9]

Preparation of Statement of Financial Accounting Standards (PSAK)

Bank Indonesia in cooperation with other related parties has completed financial accounting standards in accordance with the sharia principles that could be used as standard reference for sharia banking operational activities in Indonesia. These standards were issued in the form of Statement of Financial Accounting Standards (Pedoman Standar Akuntasi Keuangan/PSAK) number 59 and was expected to be implemented as of 1 January 2003 for the national sharia banking activities. The process of developing the PSAK number 59 involved the Association for Indonesian Accountants (Ikatan Akuntan Indonesia/IAI), Bank Indonesia, and sharia banking practitioners, using as reference the Accounting and Auditing Standards for Islamic Institutions issued by AAOIFI, Bahrain. As a follow up of this PSAK, in 2002, the Indonesian Sharia Banking Accounting Guidelines (Pedoman Akuntansi Perbankan Syariah Indonesia/PAPSI) and Sharia Banking Audit Guidelines (Panduan Audit Perbankan Syariah/PAPS) were prepared. Development of the Indonesian Sharia Banking Accounting Guidelines have been completed but they have yet to be ratified, while the Sharia Banking Audit Guidelines were still being developed.

Preparation of Sharia Banking Supervision Guidelines

Guidelines for sharia banking supervision has been completed in 2002, which are needed as a reference point for conducting investigation and supervision on national sharia banks. The guidelines would be further amended by the adoption of the 25 basic principles for effective and risk-based bank supervision.

Preparation of Short-term Funding Facility (FPJP) for Sharia Banks

In the framework of Bank Indonesia's function as lender of the last resort for the banking sector, in addition for conventional banking, short-term funding facility (Fasilitas Pendanaan Jangka Panjang/FPJP) is

9 A Sharia Unit is a special working unit in a branch office or an office under a conventional commercial bank branch office, which business activities concern fund mobilization and provision of other banking services based on sharia principles. This is in connection with the preparation by conventional commercial banks for transforming their branch offices or offices under conventional branch offices into sharia branch offices. For each opening of a sharia unit, conventional commercial banks are obliged to set aside certain amount of working capital into the account of the sharia business unit. Within at the latest 3 years' period, the sharia unit should be transformed into a sharia branch office, by fulfilling the requirements for opening a sharia branch office (including the requirement for provision of capital). In the case where the conventional commercial bank cannot fulfill the requirements, Bank Indonesia will revoke the business permit of the branch office or the office under the conventional commercial bank branch office where the sharia unit is located.

also needed for sharia banks, which is arranged to be consistent with the characteristics of sharia banking. In line with the preparation of FPJP for conventional banking, discussion on the substances of stipulations on short-term funding facility for sharia banking has been completed in 2002 and the stipulations are currently at legal drafting stage.

Review on Sharia BPR (BPRS) Performance Indicator

During the reporting period, Bank Indonesia has undertaken research on the performance indicators of BPRS based on Performance Indicator (PI) method, as an alternative to the conventional performance measurement (CAMEL). The use of PI as a measurement instrument of BPRS performance evaluation is expected to provide reasoning ground on the availability of alternate evaluation method for BPRS performance that is more suitable to the characteristics of BPRS as micro financial institution. Several more superior points of the PI method over the CAMEL method included its capability to give a picture on financial capability, portfolio quality, productivity and operational coverage, which are the characteristics micro finance institutions such as BPRS. In addition, performance evaluation using the PI method is considered to be more prudent, and as such it is recommended as an alternative for BPRS performance evaluation in addition to the CAMEL method that has been used so far.

Increase Public Understanding of Sharia Banking

During the year, socialization program to increase public understanding of sharia banking has been held intensively in various regions in cooperation with the Moslem Religious Leader Councils, universities, Sharia Economic Society and a few other institutions, including mass organization such as Nadathul Ulama (NU) and Muhammadiyah. Activities on public education were carried out in seminar, workshop, as well as discussion and coverage in print- and electronic-mass-media, and books concerning sharia banking. In order to stimulate the active role of all sharia banking stakeholders, a coordination institution should be established. This institution could involve all participants of and parties related to the sharia banking to jointly and continuously socialize and educate the public, so that the public could have better understanding on sharia banking, and in turn would stimulate the growth and stability of sharia banking system.

Sharia Banking International Cooperation

International Islamic Financial Market (IIFM)

Since 2000, Bank Indonesia has been involved actively in the development of the International Islamic Financial Market (IIFM), an institution with a function to develop and regulate the instruments and mechanism of international sharia financial market. The IIFM was established by Bank Indonesia together with banking authorities in Malaysia, Brunei Darussalam, Bahrain, Sudan and the IDB. Bank Indonesia participation in this institution is advantageous to the development of sharia financial institution, in particular for liquidity management in order to increase efficiency in the management of sharia banking funds. During 2002, the IIFM with its secretariat in Manama, Bahrain, has consolidated and prepared the instruments for organization and development of operational system and procedures. Operations of the IIFM are expected to start in 2003.

Islamic Financial Services Board (IFSB)

The rapid growths of sharia financial industry in some countries have raised the need for an international institution that has a function to: (1) prepare and disseminate core principles and standards of supervision and regulation, apply sharia principles in sharia financial industry, to be adopted voluntarily by member countries; (2) liaise and cooperate with institutions that determine the standards in the monetary and financial stability; and (3) stimulate best practice in risk management through research, training and technical aids. Consequently, in Paris during November 2001 a number of central bank governors and senior officials of countries that have developed sharia banking/financial institutions, namely Bahrain, Egypt, Iran, Pakistan, Sudan, Jordan, Malaysia and Indonesia, as well as representatives from the IDB, AAOIFI and IMF, decided to establish the Islamic Financial Services Board (IFSB). On November 3, 2002 the IFSB was officially established with a secretariat resided in Kuala Lumpur, Malaysia.

During its first assembly on November 3, 2002, Bank Indonesia Governor was elected as Chairman of IFSB. The active involvement of Bank Indonesia in this institution is deemed important in order to prepare regulation, supervision system and best practices guidelines that are consistent with international standards for sharia banking. In addition to the contribution given to the institution through synergy approach, Bank Indonesia could take advantage of the result of researches and developments of this institution to enhance the completion of sharia banking regulation and supervision in Indonesia.

Policy on the BPR Area

As one of the efforts to improve banking infrastructures, the policy to develop BPR is continued. One of the efforts to develop BPR was through a cooperation with the Gesselschaft fur Technische Zusammenarbeit (GTZ) in the Promotion of Small Financial Institutions (ProFI) project, covering implementation of certified training for BPR management, as well as amendment of BPR supervision system and regulations. In addition, in line with Bank Indonesia’s objective to rehabilitate the BPR industry, the United States Agency for International Development (USAID) in cooperation with The Asia Foundation (TAF) have submitted terms of reference for a technical assistance program on the rehabilitation of problem BPR within the Jakarta, Bogor, Tangerang and Bekasi (Jabotabek) area, including efforts to bring together BPR and prospective investors when BPR need new capitals. In this respect, 40 problem BPR within the Jabotabek area have been invited to the TAF and USAID presentation at Bank Indonesia on September 24, 2002, and 26 of them have stated their interests to join the TAF program. Furthermore, a cooperation with academicians was also undertaken in relation to the preparation of BPR blue print through a Base Line Survey for BPR within the Jabotabek, West java, Central Java and West Sumatera areas.

In order to promote various initiatives and micro finance approaches, which aim to alleviate poverty and stimulate the grassroots economy, Bank Indonesia supported the National Meeting and Micro Finance

Bazaar in July 2002. As a follow up, a plan has been set to establish the Center for Micro Finance Institution (LKM) in Bank Indonesia, which will function as: (i) an center information for micro finance for stakeholders; (ii) provider of technical assistances for LKM; and (iii) facilitator of cooperation between formal financial institutions and LKM (linkage program) in order to expand the outreach of micro finance institutions in providing services to micro business.

Progress of Commercial Banks

Institution

Up to the end of the reporting year, the total number of operating banks dropped by 4 from earlier year to 141 banks, due to the merger of 5 private national banks into Bank Permata[10] in September 2002. Despite this smaller number of banks, the total number of bank offices rose from 6,765 to 7,001 at the end of the reporting year. The rise occurred particularly in the private national foreign exchange banks and the state banks.

Of the 141 existing banks, the government owned 37 banks (26.24%), comprising 5 state banks, 3 formerly taken-over banks, 3 recapitalized banks and 26 BPDs (12 recapitalized and 14 non-recapitalized BPDs). The remaining comprises 69 A-category banks and 1 taken-over bank that has been divested (49.64%) owned by the national private sector, 24 foreign joint venture banks (17.02%) owned by the national private sector and foreign parties, and 10 foreign banks (7.09%) owned by foreign parties.

Commercial Bank Business Activity

In general, the performance of commercial banks in the reporting year showed a tendency of improving, although some indicators demonstrated slower growth. This was reflected in the ongoing process of recovering the bank intermediation function through increases in new credit extension, LDR, credit to earning asset ratio, and ratio of income on credit interest to total income on interest. This was also seen in the higher capital and profitability, as well as credit quality. The performance of the banking sector was associated with better macro economic and monetary conditions as reflected in the reduced SBI rates, restrained inflation

Table 8.1
Number of Banks and Bank Offices

Group of Banks	Outstanding			Growth (%)		Share[1)] (%)
	2000	2001	2002	2001	2002*)	
I. Commercial Banks						
Number of Banks	151	145	141	-4.0	-2.8	100.00
Number of offices[2)]	6,509	6,765	7,001	3.9	3.5	100.00
State-owned Banks						
Number of Banks	5	5	5	0.0	0.0	3.55
Number of Offices	1,736	1,807	1,885	4.1	4.3	26.92
Regional Development Banks						
Number of Banks	26	26	26	0.0	0.0	18.44
Number of Offices	826	857	909	3.8	6.1	12.98
Private National Forex Banks						
Number of Banks	38	38	36	0.0	-5.3	25.53
Number of Offices	3,302	3,432	3,565	3.9	3.9	50.92
Private National Non-Forex Banks						
Number of Banks	43	42	40	-2.3	-4.8	28.37
Number of Offices	535	556	528	3.9	-5.0	7.54
Joint Banks						
Number of Banks	29	24	24	-17.2	0.0	17.02
Number of Offices	57	53	53	-7.0	0.0	0.76
Foreign Banks						
Number of Banks	10	10	10	0.0	0.0	7.09
Number of Offices	53	60	61	13.2	1.7	0.87
II. Rural Credit Banks	7,764	7,703	7,571	-0.8	-1.7	-
Rural credit agencies	5,345	5,345	5,345	0.0	0.0	-
Non-rural credit agencies	2,419	2,358	2,226	-2.5	-5.6	-

1) Share to all commercial banks
2) Excluding rural unit of BRI

10 Consisted of Bank Bali, Bank Universal, Bank Prima Express, Bank Artamedia and Bank Patriot

rate and firmer rupiah.

Total Assets and Earning Assets

Banks' total assets in aggregate rose by 1.1% from year 2001 to Rp1,112.2 trillion, mainly driven by the expansion in extended credit portfolio and SBI portfolio (Table 8.2). Viewed from the asset ownership side, the state bank group has the largest share of banks' total assets with 46.4% (Rp516.6 trillion), followed by the formerly taken-over bank group with 19.4% (Rp216.2 trillion) and the A-category bank group with 11.1% (Rp123.9 trillion) (Graph 8.1).

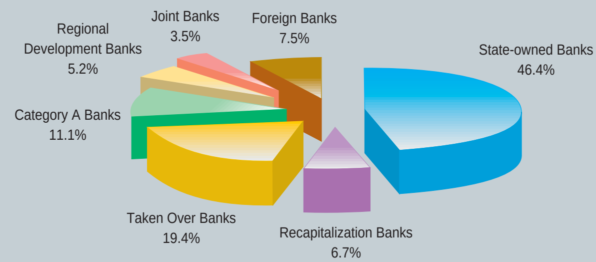
Corresponding with the surge in credit portfolios and government bonds tradable in the secondary market, as well as the asset to bond swap program, the banks' earning assets during the year in review were shifted to credits, while in the past years earning assets were dominated by government bonds (Graph 8.2).

The credit position rose from 34.8% in December 2001 to 40.1% at the end of the reporting year, and the government bond position dropped from 38.5% to 35.2%. Formerly joint-venture banks had the biggest portion of credits (63.0%), followed by A-category bank group (55.2%), and BPD group (46.0%). Meanwhile, state-bank group owned the biggest portion of government bonds (50.4%), followed by recapitalized-bank group (45.7%) and formerly taken-over bank group (43.3%).

(Trillions of Rp)

Table 8.2
Commercial Bank Performance Indicators

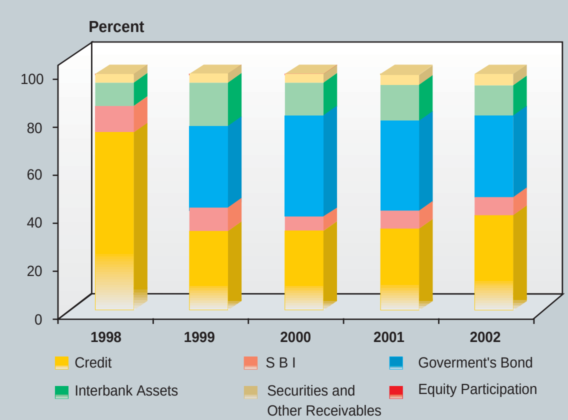
Indicators	1998	1999	2000	2001	2002
Total Assets	895.5	1,006.7	1,030.5	1,099.7	1,112.2
Third Party Funds	625.3	617.6	699.1	797.4	835.8
Deposits	545.5	277.3	320.4	358.6	410.3
LDR (%)	72.4	26.2	33.2	33.0	38.2
NPLs - gross (%)	48.6	32.8	18.8	12.1	8.3
NPLs - net (%)	34.7	7.3	5.8	3.6	2.9
Capital	(129.8)	(41.2)	53.5	62.3	93.0
CAR	(15.7)	(8.1)	12.5	20.5	22.5
Profit (Loss) before					
tax Net Interest	(178.6)	(75.4)	10.5	13.1	21.9
Margin	(61.2)	(38.6)	22.8	37.8	42.9



Graph 8.1
Assets by Group of Banks

Funds Accumulation

Better economic conditions as reflected in the higher GDP and the restoration of public confidence in the national banking system, have stimulated the rise in third-party funds although lower than that of



Graph 8.2
Composition of Earning Assets

Table 8.3
Composition of Deposits

Type of Deposits	Outstanding (Trillions of Rp)			Growth (%)		Share (%)	
	2000	2001	2002	2001	2002	2001	2002
Demand Deposits	**161.5**	**186.2**	**197.0**	**15.3**	**5.8**	**23.3**	**23.6**
- Rupiah	103.6	120.0	130.2	15.8	8.5	64.5	66.1
- Foreign currency	57.9	66.2	66.8	14.3	0.9	35.5	33.9
Time Deposits	**384.7**	**439.9**	**446.2**	**14.4**	**1.4**	**55.2**	**53.4**
- Rupiah	296.7	344.9	364.6	16.2	5.7	78.4	81.7
- Foreign currency	88.0	95.1	81.6	8.0	(14.1)	21.6	18.3
Saving Deposits	**152.9**	**171.3**	**192.6**	**12.0**	**12.4**	**21.5**	**23.0**
Total	**699.1**	**797.4**	**835.8**	**14.1**	**4.8**	**100.0**	**100.0**
- Rupiah	553.2	636.2	687.4	15.0	8.1	79.8	82.2
- Foreign currency	145.9	161.2	148.4	10.5	(8.0)	20.2	17.8

2001. In nominal terms, third-party funds during 2002 expanded by 4.8% or Rp38.5 trillion, from Rp797.4 trillion to Rp835.8 trillion, adding to the 2001 increase of 14.1% or Rp98.3 trillion. Using constant exchange rate (December 2000), banks' third-party funds in 2002 expanded by Rp61.8 trillion or 7.9%, still lower than that of 2001 which rose by Rp85.8 trillion or 12.3%.

Aside from the decreases in nominal deposit interest rates in line with the downward trends of SBI interest rates, the lower growth of third-party funds during the reporting year was due to the existence of alternates to time deposits, which promised higher return, especially mutual funds.

By composition, time deposits still dominated third-party funds with a share of 53.4%, although lower by 1.8 points relative to year 2001. The shares of demand deposits and saving deposits were 23.6% and 23.0% respectively, or 0.3 points and 1.5 points above the 2001 levels.

Bank Intermediation

During the reporting year, the recovery in bank intermediation has advanced. This was indicated by higher outstanding credits and actual channeling of new credits, as well as changes in the structure of the earning assets of the banking system.

Bank credits continued to expand, especially credits in rupiah. But credits in foreign currencies have fluctuated as an effect of exchange rate valuation (Table 8.4). In nominal terms, outstanding credits in December this year amounted to Rp410.3 trillion, a net expansion after repayments of Rp51.6 trillion (14.4%), higher than the Rp38.2 trillion (11.9%) rise in 2001. However, excluding the exchange rate valuation effect and using a constant exchange rate (December 2000), outstanding credits during 2002 have expanded Rp70 trillion (20.1%), above the Rp28.1 trillion (8.8%) increase in 2001.

A Constant share of credits were channeled to the business sector during the reporting year. The highest portion (33.1%) was extended to the industrial sector, followed by the trade sector (17.9%), the business services sector (8.6%) and the agricultural sector (6.1%). Business sectors that experienced the highest credit growth in 2002 were the transportation sector (65.6%), the trade sector (34.4%), the social services sector (28.5%) and the mining sector (27.3%). As regards the uses of credit, the highest portion of credits was still dominated by working capital credits (Kredit Modal Kerja/KMK) for Rp206.6 trillion (55.7%), investment credits (Kredit Investasi/KI) for Rp84.4 trillion (22.8%) and consumer credits (Kredit Konsumsi/KK) for Rp80 trillion (21.6%). However, from the growth viewpoint, consumer credits experienced the highest growth of 36.5%, followed by working capital credits of 13.8% and investment credits of 11.3% (Table 8.4).

During the reporting year, banks were able to extend Rp79.4 trillion in new credits, an increase of Rp22.6 trillion (39.8%) from Rp56.8 trillion in 2001. The monthly average of new credits extended during the year was Rp6.6 trillion, or Rp1.9 trillion (38.6%) higher than Rp4.7 trillion in 2001 (Table 8.5).

As was the case in the past year, KMK still dominated actual new credits extended, at Rp50.3 trillion or 63.3% of total new credits. Meanwhile, KI were Rp17.5 trillion (22.1%), and KK were Rp11.6 trillion (14.6%). One favorable development was the 73.3% rise in KI extension from Rp10.1 trillion in 2001 to Rp17.5 trillion in the reporting year (Table 8.5).

Of the total credits extended during 2002, Rp32.7 trillion (41.1%) were credits to debtors with a ceiling below Rp5 billion, i.e. micro credit and credit to SMEs. Meanwhile the proportion of credits extended fluctuated between the 32.0%-64.3% range each month. The portion of credits extended to SMEs has expanded because some

Table 8.4
Development in Bank Credit

Item	Outstanding (Trillions of Rp)			Growth (%)		Share (%)	
	2000	2001	2002	2001	2002	2001	2002
By Economic Sectors [1]							
- Agriculture	20.0	21.3	22.7	6.5	6.5	6.7	6.1
- Mining	5.3	3.1	3.9	(41.7)	27.3	1.0	1.1
- Industry	110.5	118.7	122.7	7.4	3.4	37.5	33.1
- Electricity, Water and Gas	5.1	5.1	4.4	(0.6)	(14.0)	1.6	1.2
- Contruction	7.2	8.2	9.4	14.4	13.9	2.6	2.5
- Trade	46.2	49.3	66.3	6.6	34.4	15.6	17.9
- Transportation	7.3	7.6	2.6	3.7	65.6	2.4	3.4
- Business Services	26.5	27.7	31.8	4.5	14.6	8.8	8.6
- Social Services	2.9	3.6	4.6	20.8	28.5	1.1	1.2
- Others	52.0	71.5	92.9	37.6	29.8	22.6	25.0
Total	**283.1**	**316.0**	**371.1**	**11.6**	**17.4**	**100.0**	**100.0**
By Usage [1]							
- Working Capital	174.0	181.6	206.6	4.4	13.8	57.5	55.7
- Investment	68.8	75.8	84.4	10.2	11.3	24.0	22.8
- Consumption	40.3	58.6	80.0	45.5	36.5	18.5	21.6
Total	**283.1**	**316.1**	**371.1**	**11.6**	**17.4**	**100.0**	**100.0**
By Type of Bank							
- State Owned Bank	142.7	159.9	185.4	12.1	16.0	44.6	45.2
- Recapitalization Bank	36.3	27.7	21.3	(23.6)	(23.1)	7.7	5.2
- Former BTO	21.4	35.5	59.7	65.9	68.2	9.9	14.5
- A-Category Bank	32.4	44.7	59.1	38.0	32.2	12.5	14.4
- Regionan Dev. Bank (BPD)	11.5	17.1	23.3	48.5	36.8	4.8	5.7
- Joint Bank	29.4	29.2	25.1	(0.6)	(13.9)	8.1	6.1
- Foreign Bank	46.9	44.7	36.3	(4.7)	(18.7)	12.5	8.9
Total	**320.5**	**358.6**	**410.3**	**11.9**	**14.4**	**100.0**	**100.0**
By Currency							
- Rupiah	178.0	228.6	296.9	28.4	29.9	63.7	72.4
- Foreign Currency	142.4	130.1	113.4	(8.7)	(12.8)	36.3	27.6
Total	**320.5**	**358.6**	**410.3**	**11.9**	**14.4**	**100.0**	**100.0**

Note : 1) Excluding channeling

banks changed their orientation from corporate to retail.

The increase in new credits extended during the year has successfully raised the LDR, which came to 38.2% at the end of the period, or above the 33% at the end 2001. The rise in the LDR was far below the 70%-80% ideal target range. With improved economic conditions, decreasing inflation and interest rates, credit growth was able to move up significantly (Graph 8.3).

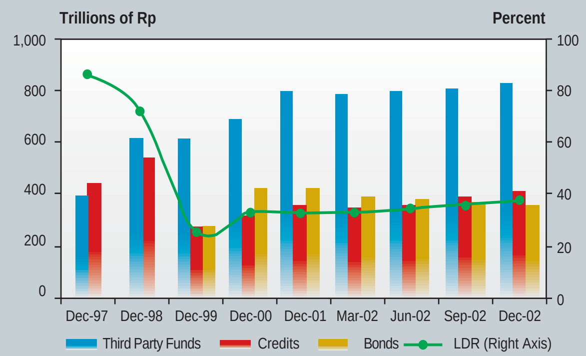
Quality of Bank Credit

The quality of bank credit as reflected in the nominal value and the ratio of NPL has improved. In nominal terms, non-performing loans (NPLs) dropped from Rp43.4 trillion in December 2001 to Rp33.2 trillion at the end of the reporting year. This was mostly due to the credit restructuring and write-offs completed by banks. In line with the declining nominal NPLs and rising outstanding bank credits, the gross NPL ratio improved from 12.1% in December 2001 to 8.3% at the end of the reporting year, while the net NPL ratio improved from 3.6%

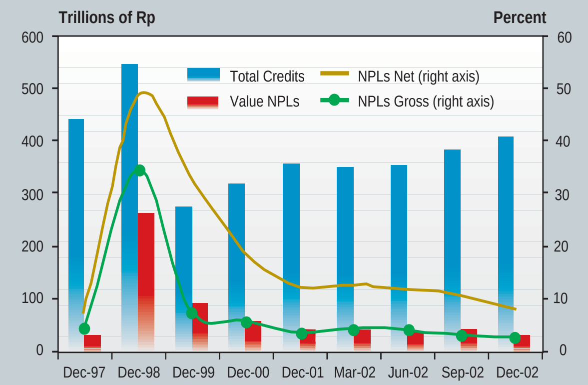
(Billions of Rp)

Tabel 8.5
Development in Realized New Credit

New Credit	2001	2002					Growth (%)	Share (%)
		Qtr I	Qtr II	Qtr III	Qtr IV	Total		
By Economic Sectors								
- Agriculture	2,579	464	755	768	606	2,593	0.5	3.3
- Mining	1,972	520	63	98	711	1,392	(29.4)	1.8
- Industry	18,390	3,496	3,732	11,061	5,027	23,316	26.8	29.4
- Electricity, Water and Gas	367	9	13	280	23	325	(11.5)	0.4
- Contruction	1,703	286	477	2,751	869	4,382	157.3	5.5
- Trade	10,785	2,224	3,725	6,488	4,183	16,621	54.1	20.9
- Transportation	2,309	569	2,350	2,536	1,566	7,022	204.2	8.8
- Business Services	6,371	2,068	2,891	2,491	3,251	10,701	68.0	13.5
- Social Services	989	85	138	216	147	586	(40.7)	0.7
- Others	11,352	2,837	3,339	3,458	2,845	12,478	9.9	15.7
Total	**56,817**	**12,557**	**17,484**	**30,146**	**19,229**	**79,416**	**39.8**	**100.0**
By Type of Bank								
- State Owned Bank	12,894	3,129	5,103	10,362	4,244	22,838	77.1	28.8
- Recapitalization Bank	2,819	713	936	1,905	1,363	4,916	74.4	6.2
- Former BTO	13,069	3,761	4,345	7,969	5,028	21,103	61.5	26.6
- A-Category Bank	17,417	3,001	5,852	7,446	6,780	23,079	32.5	29.1
- Regional Dev. Bank (BPD)	1,584	308	453	722	485	1,968	24.2	2.5
- Joint Bank	2,655	429	322	992	724	2,468	(7.1)	3.1
- Foreign Bank	6,378	1,217	474	750	605	3,045	(52.3)	3.8
Total	**56,817**	**12,557**	**17,484**	**30,146**	**19,229**	**79,416**	**39.8**	**100.0**
By Usage								
- Working Capital	38,230	7,717	10,489	19,890	12,180	50,276	31.5	63.3
- Investment	10,120	2,169	4,108	7,063	4,198	17,538	73.3	22.1
- Consumption	8,467	2,672	2,887	3,193	2,850	11,603	37.0	14.6
Total	**56,817**	**12,558**	**17,484**	**30,146**	**19,229**	**79,417**	**39.8**	**100.0**



Graph 8.3
Third Party Funds, Credits, and LDR



Graph 8.4
Non-Performing Loans

to 2.9% (Graph 8.4).

Up to the end of the reporting period, the number of banks with net NPL ratio above 5% was 20, lower by 25 banks than in December 2001. This condition made the below 5% indicative target of the net NPL ratio in December 2002 difficult to achieve. Moreover, banks were confronted with a possible worsening of credit quality as a result of the Bali tragedy. Consequently, Bank Indonesia decided to have it suspended until June 2003. Bank Indonesia has asked those banks failing to meet the target to prepare for an action plan for the attainment of the below 5% net NPL ratio within their business plan.

Profitability

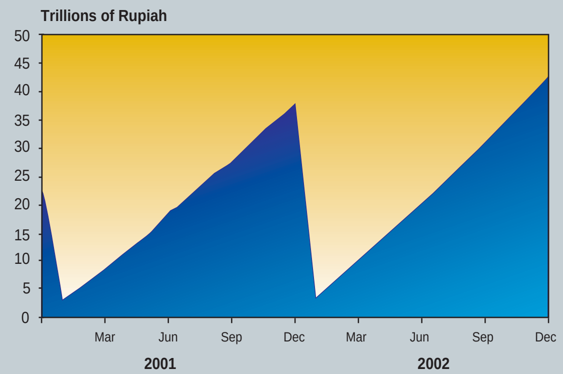
Despite the downward trends of SBI and Bank Indonesia Deposit Facility (FASBI) rates in 2002 that affected income from the coupon of government bonds series VR (VRB), banks were still able to record positive Net Interest Income (NII), which was even higher than in 2001. In 2002 banks posted Rp42.9 trillion NII, while in 2001 only Rp37.8 trillion.

The higher NII resulted from the expansion of

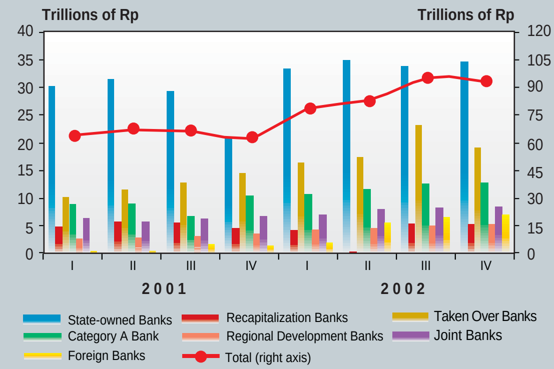
(Billions of Rp)

Tabel 8.6
Small-Medium Credit (Below Rp 5 billion)

Small-Medium Credit	2001	2002					Growth (%)	Share (%)
		Qtr I	Qtr II	Qtr III	Qtr IV	Total		
By Type of Bank								
- State-owned Bank	3,887	981	1.747	1.811	1.817	6.356	**63,5**	**19,5**
- Recapitalization Bank	1,491	379	452	601	577	2.009	**34,7**	**6,2**
- Former BTO	7,430	1,945	2.659	3.234	2.214	10.053	**35,3**	**30,8**
- A-Category Bank	8,909	2,005	3.124	3.709	2.677	11.516	**29,3**	**35,3**
- Regional Dev. Bank (BPD)	1,324	270	418	713	382	1.782	**34,6**	**5,5**
- Joint Bank	322	61	120	110	184	476	**47,8**	**1,5**
- Foreign Bank	427	123	127	102	111	462	**8,4**	**1,4**
Total	**23,790**	**5,765**	**8.647**	**10.280**	**7.962**	**32.654**	**37,3**	**100,0**
% Share to Total New Credit	41,9	45.9	49,5	34,1	46,3	41,1	-	-



Graph 8.5
Net Interest Income



Graph 8.6
Banks' Capital

new credits and the relatively high interest rates on credits, so that income from interest was relatively high, on the other hand, deposit interest rate (cost of fund) experienced somewhat sharp decreases following SBI discount rates. In line with the higher NII, before-tax profits earned by banks also rose from Rp13.1 trillion in 2001 to Rp21.9 trillion in 2002 (Graph 8.5).

Capital and CAR

Overall bank capital rose from Rp62.3 trillion in December 2001 to Rp93.0 trillion at the end of the reporting period. This rise in capital largely stemmed from additional paid-in capital of Rp8.3 trillion, reserves for capital of Rp2.7 trillion, correction to past-year losses of Rp12.3 trillion and current-year profits of Rp7.0 trillion. The higher capital mainly occurred in the state-bank group with Rp14.0 trillion, followed by the foreign bank group with Rp5.6 trillion and formerly taken-over bank group with Rp4.5 trillion.

Improved bank asset quality followed by higher capital have raised banks' CAR. At the end of 2002, overall commercial banks' CAR reached 22.5% or 199 points above the 20.5% at year end 2001. On an individual basis, there were 3 remaining banks with CARs still below 8%.

Progress of Sharia Banking

As a relatively new financial industry, sharia banking showed significant growth during 2002. This was reflected in the rising number of banks operating based on sharia principles and the relatively high growth of assets, third party funds, and financing rendered (PYD). The sharia financial market also started to grow and develop more.

Institutional Development

In 2002, the sharia banking office network has expanded as marked by 3 conventional commercial banks (BUK) that set up Sharia Business Unit (UUS) and by the operations of 2 new BPR Sharia. Up to the end of 2002 there were 2 Sharia Commercial Banks (BUS), 6 Sharia Business Units, 127 bank offices and 83 BPR Sharia (Table 8.7) which scattered around 20 provinces in Indonesia. Meanwhile at the end of 2002 there was 1 conventional commercial bank applying to open a

Table 8.7
Sharia Banking Offices Network

Item	1992	1999	2000	2001	2002
Commercial Sharia Bank	1	2	2	2	2
Sharia Business Unit	0	1	3	3	6
Number of Offices	1	40	62	96	127
Sharia Rural Credit Bank	9	78	78	81	83

(Percent)

Table 8.8
Share of Sharia Banking Activities to Total Domestic Bank

Item	2000	2001	2002
Assets	0.17	0.25	0.37
Deposits	0.15	0.23	0.35
Financing	0.40	0.57	0.80

Sharia Business Unit, 8 requests to open sharia branch offices, and 2 requests to establish BPR Sharia. All the requests were still in the process of waiting for operational license approval. This rapid growth of the sharia banking office network was supported by Bank Indonesia through regulations as well as socialization of sharia banking to the public.

Business Activities

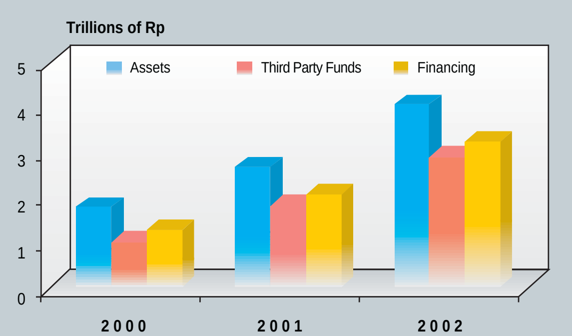
Total Assets

In line with the expansion in banking office network, business activities of sharia banking also experienced rapid growth (Graph 8.7). At the end of 2002, total assets of sharia banking were recorded at Rp4.1 trillion, which experienced significant growth of Rp1.4 trillion or 50.3% relative to the earlier year. As a result, the portion of sharia banking total assets against the national banking total assets rose from 0.3% at the end of 2001 to 0.4% at the end of reporting period (Table 8.8).

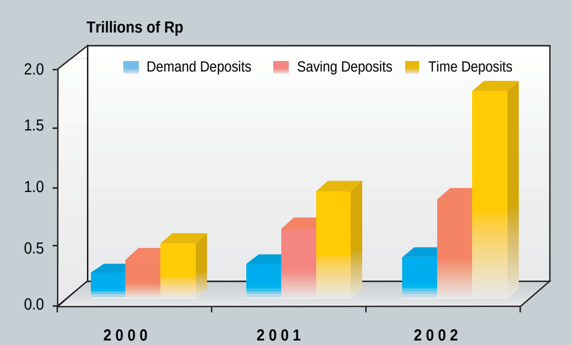
Funds Accumulation

In general, the growth of accumulated third party funds of sharia banking in 2002 was recorded at 61.5%. This additional third party funds contributed 2.9% of the total additional national banking third party funds. Meanwhile, contribution of third party funds to total assets of sharia banking in 2002 was 71.4% or above the 66.4% in earlier year (Graph 8.8).

The higher third party funds occurred in nearly



Graph 8.7
Business Activities of Sharia Banking



Graph 8.8
Composition of Third-Party Funds

all components, namely demand deposits 19.7%, saving deposits 38.0% and time deposits 90.4%, while the composition remained the same as in the past year. Time deposits still dominated third party funds with higher portion from 50.7% at the end of 2001 to 59.8% at the end of reporting year. (Graph 8.8).

The rapid growths of sharia banking third party funds within the last two years indicated that the public responded positively. This development was in line with the research conducted by Bank Indonesia concerning public preference for sharia banking. The rising office network and service facilities, such as joint ATM, were factors behind the growth of third party fund. Besides, the ceaseless activities on the socialization, education and promotion of sharing banking carried out by Bank Indonesia, Sharia banks, universities, and Association for Indonesia Sharia Banks (ASBISINDO) have raised public preference for sharia banking.

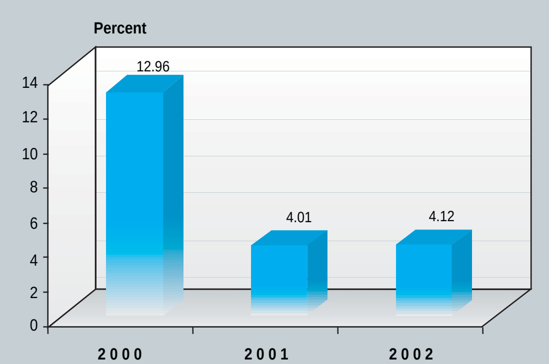
Financing and Financing Quality

In 2002 financing of sharia banking grew 59.9% from Rp2.1 trillion to Rp3.3 trillion, slightly lower than 61.3% growth in the previous year. Financing of sharia banking was still dominated by financing with *aqad murabahah* (sale with markup) of 70.9%, followed by *mudharabah* (profit-loss sharing) of 15.2%, and *musyarakah* (mutual partnership profit-loss sharing) of 1.8%. Other forms of financing such as *salam* (advance purchase), *istishna'* (commissioned manufacture), *ijarah* (operational lease), *gadai* (mortgage) and *hawalah* (transfer services) came with smaller portion.

The portion of *aqad murabahah* financing experienced an increase from 69.3% in 2001 to 70.9% in the reporting year. The use of *aqad murabahah* financing was due to its characteristic factor that the return rate of *murabahah* financing could be projected, because third party funds stemmed largely from short-term funds, thus simplifying the bank asset and liability management (ALMA). This was in line with Bank Indonesia research on the performance of BPR Sharia industry during the year, which indicated that the public gave preference to *aqad murabahah* financing because of its simple calculation.

The growing financing of sharia banking was also followed also by efforts to maintain its earning assets quality as reflected in the ratio of sharia banking Non Performing Financing (NPF), that could be kept below 5% (Graph 8.9). Meanwhile, Financing to Deposit ratio (FDR) of sharia banking, i.e. comparison of financing rendered and third party funds, within the last three years remained above 100%, respectively 123.5% in 2000, 113.5% in 2001, and 112.3% in 2002. This showed that sharia banking intermediation function has run well.

In line with Bank Indonesia's policy to stimulate the development of small and medium scale business, sharia bank has given relatively good response. This



Graph 8.9
Composition of Gross Financing Extended

Table 8.9
Realized Financing Extended to SMEs

Item	2001	2002[1]	Growth (%)
	(Billions of Rp)		
Commercial Sharia Bank	299	472	57,9
Sharia Business Unit	114	149	30,7
Sharia Rural Credit Bank	113	119	5,3

1) For BPR Sharia September 2002 data

was seen in the rise of total financing allocated to the small and medium scale business in 2002, namely 57.9% to sharia commercial banks, 30.7% to sharia business units and 5.3% to BPR Sharia (Table 8.9). The financing portfolio for small and medium scale business from sharia commercial banks has reached 20% of the total financing rendered.

Solvency and Profitability

In general the solvency of sharia banking within the last two years was roughly good, as seen in the CAR that remained above 8%, despite the drop from 21.5% in the past year to 14.8%. This was largely due to the expansion in financing (59.9%) which was far above the add-in bank capital (16.4%). If this trend continued, sharia banking should increase paid-in capital within a short time in order to maintain CAR above 8%.

During the reporting year, the sharia banking was able to post accumulative profit of Rp54.1 billion, with Return on Asset (ROA) and Return on Equity (ROE) of respectively 1.6% and 10.1%. Industrial-wise, ROE in 2002 was lower than 17.7% ROE in the past year, because the sharia business units that just started their operations during the reporting year have not reached their break-even point yet. Nevertheless, with the growing number of sharia banking operations, soon the economic scale of sharia banking industry will be attained. On the other hand, sharia banking is expected to increase competitiveness in the coming future in line with the downward trend of SBI discount rates followed by saving and time deposits interest rates of the conventional banking.

Sharia Financial Market

The instruments of sharia financial market comprised Bank Indonesia Wadiah Certificate (SWBI), Inter-bank Money Market based on Sharia Principles (PUAS), and Sharia Bonds. SWBI position at the end of 2002 was recorded at Rp390 billion, with average outstanding of Rp319 billion per month. The outstanding SWBI trended lower during the second semester 2002, which were shifted to financing rendered (PYD), in line with the expanded needs of the real sector.

In the meantime, activities in PUAS during the year showed upward tendency and reached its top position in October 2002 with a transaction volume of Rp14.2 billion. The higher PUAS volume was also related to increased participants in PUAS.

To provide investment alternatives in sharia banking investment, in 2002 for the first time sharia bonds were issued by one of the state-owned banks amounted to Rp100.0 billion of the Rp1.0 trillion total bonds. The issuance of those sharia bonds was responded positively, the initial offer was oversubscribed to Rp175.0 billion.

Progress of BPR

Institutional Development

During the reporting year, the total number of operating BPR was 2,141 and there were 82 BPR operating under the sharia principle. The number was reduced due to revocation of some BPR business licenses.

During the period in review, Bank Indonesia has abolished the business licenses of 151 BPR (109 BPR with frozen activities and 42 BPR under direct revocation), and 78 BPR had been frozen. Of the frozen BPR, 8 could be rescued through acquisition process and would not be revoked.

Business Activities

BPR industry enjoyed significant progress, as reflected in the rising total assets, funding and credit extensions. Total BPR assets rose by 24.4% from Rp6,747 billion at the end-position in 2001 to Rp8,393 billion at the end-position in September 2002.

As regards funding, the savings and time deposits experienced expansion. Total amount of saving deposits rose 18.6% from Rp1,574 billion at the end-position in 2001 to Rp1,867 billion at end of September 2002. Time deposits increased by 24.2% from Rp2,706 billion at the end of 2001 to Rp3,370 billion at end of September 2002 (Table 8.10).

In line with the rising accumulated funding, on the disbursement side, credit extensions also expanded by 32.1% from Rp4,860 billion at the end of 2001 to Rp6,420 billion at end of September 2002. The above-mentioned condition demonstrates growing public confidence in BPR and good future prospects.

BPR's credit quality showed improvement too, as seen in the decrease of NPLs from 12.0% at end the end of 2001 to 9.0% in the reporting year. The higher credit quality was followed by an increase in profits gained by BPR, as reflected in the current-year BPR's profit that rose by 170.3% from Rp223.0 billion in the previous year to Rp294.0 billion.

(Billions of Rp)

Table 8.10
Business Activities of Rural Credit Banks (BPR)

Item	2000	2001	2002[1)
Assets	4,731	6,747	8,393
Deposits	3,082	4,280	5,597
Credits	3,619	4,860	6,420
Paid in Capital	705	936	1,096
Profit (Loss)	116	223	294

1) September 2002

OTHER FINANCIAL INSTITUTIONS

In line with better banking conditions during 2002, the performance of non-bank financial institutions, such as multi-finance companies and the state-owned pawn company (perum pegadaian) also improved, viewed from the total assets, total value of business activities and profits earned. This favorable development was indirectly caused by the increase of banks' financing. On the other hand, the recovery process of bank intermediation function provides space on alternative financing from these institutions, particularly for public and SMEs.

Multi-finance

Up to November 2002, the total assets of multi-finance companies rose by 8.1% relative to the year before, from Rp37.3 trillion to Rp40.4 trillion. The total value of business activities (financing) meanwhile increased by 7.9% from Rp30.8 trillion to Rp33.3 trillion. Another favorable development was the Rp1.5 trillion profits earned during the year, after experiencing losses for the last few years (Table 8.11).

During the year in review, business activities of multi-finance companies had encountered minor changes. If the previous periods were always dominated by leasing (sewa guna), activities during the reporting year were shifted to consumer financing, totaling Rp15.4 trillion (46.4%). Meanwhile financing of leasing activities was Rp12.8 trillion (38.6%), factoring (anjak piutang) was Rp3.3 trillion (9.9%), and credit card financing was Rp1.1 trillion (3.3%). Relative to the position in the past year, only leasing experienced a drop i.e. 9.1%, while other activities experienced expansion. The largest occurred in credit card and consumer financing of respectively 37.2% and 25.0%. This was in line with expanding domestic consumption, which was still the main drive of economic growth (Table 8.11).

Through November 2002, funds accumulated by multi-finance companies rose by Rp3.0 trillion or 8.1% compared with the position at the end of the previous year. The higher funds originated from bonds, paid-in capital and profits earned in the prevailing year. Meanwhile domestic as well as offshore borrowings dropped by respectively 2.6% and 10.1%. Funds of multi-finance companies during the reporting year still largely came from domestic bank loans of 34.2% and from offshore bank loans of 14.3%. Funds from non-bank sources accounted for 24.3%, of which 10.2% came from domestic and 14.1% from offshore (Table 8.12).

By uses of funds, the composition did not experience much change from the past year. Most funds of multi-finance companies were channeled in the form of financing, which amounted to Rp33.3 trillion or 82.4% of the total funds owned (Table 8.12). In line with the better economic condition, financing activities carried out by multi-finance companies during the reporting year also experienced higher growth, from 4.9% in 2001 to 7.9% up to November 2002. This condition gave rise to the income of multi-finance companies, and during the reporting year they recorded Rp1.5 trillion profits after experiencing losses within

Table 8.11
Selected Indicators of Multifinance Companies

Item	Outstanding (Trillions of Rp)			Growth (%)	
	2000	2001r	2002[1]	2001r	2002[1]
Number of companies[2]	245	246	247	0.4	0.4
Total Assets	35.8	37.3	40.4	4.4	8.1
Business activities	29.4	30.8	33.3	4.9	7.9
Leasing	13.7	14.1	12.8	2.9	-9.1
Factoring	6.6	3.3	3.3	-	0.4
Credit card	0.4	0.8	1.1	50.0	37.2
Consumer finance	8.5	12.4	15.4	97.3	25.0
Others	0.2	0.3	0.6	45.2	111.5
Borrowings[3]	31.3	31.1	29.4	47.4	-5.7
Domestic	17.6	18.4	17.9	-0.5	-2.6
Foreign	13.7	12.8	11.5	4.5	-10.1
Bonds	0.8	0.7	1.7	-7.0	124.2
Paid-in Capital	6.1	6.8	7.6	-	12.7
Profit (Loss)	(2.6)	(0.1)	1.5	11.2	-

1) November 2002
2) Units
3) Incl. Subordinated Loan

Table 8.12
Sources and Uses of Fund by Multifinance Companies

Item	Outstanding (Trillions of Rp)			Growth (%)	
	2000	2001r	2002[1]	2001r	2002[1]
Sources of Fund	**35.8**	**37.3**	**40.4**	**4.4**	**8.1**
Bank Borrowings	18.9	21.1	19.6	12.0	-7.5
- Domestic	11.3	14.2	13.8	25.6	-2.9
- Foreign	7.6	7.0	5.8	-8.2	-16.8
Other Borrowings[2]	12.4	10.0	9.8	-19.6	-1.8
- Domestic	6.3	4.2	4.1	-33.5	-1.4
- Foreign	6.2	5.8	5.7	-5.5	-2.1
Bonds	0.8	0.7	1.7	-11.2	124.2
Capital[3]	(2.2)	(0.6)	2.6	-73.9	551.1
Others	5.8	6.0	6.7	4.1	12.1
Uses of Funds	**35.8**	**37.3**	**40.4**	**4.4**	**8.1**
Financing	29.4	30.8	33.3	4.9	7.9
Bank deposits	3.7	3.0	3.2	-20.3	6.9
Equity participation	0.1	0.1	0.1	-19.2	2.7
Others	2.5	3.4	3.8	35.7	11.4

1) Up to November 2002
2) Incl. Subordinated Loan
3) Net capital after compensated by current year profit/loss, retained earnings and provisions

the last few years. As a result of earning profits and receiving higher paid-in capital, net capital of multi-finance companies in the reporting year became positive Rp2.6 trillion.

Multi-finance companies continued to place their funds in the industrial and trading sectors, which received financing of respectively Rp5.0 trillion (15.2%) and Rp4.7 trillion (14.2%). Placements of funds in the industrial sector dropped from Rp6.1 trillion in the previous year. Other sectors that also obtained major financing were transportation sector of Rp2.6 trillion and construction sector of Rp1.7 trillion (Table 8.13).

In view of collectability, the quality of multi-finance companies'earning assets, which consisted of financing (leasing, factoring, credit card and consumer financing), marketable securities, and equity participation, has improved from the past year. Quality of earning assets categorized as current rose from 78.4% to 82.2%. Meanwhile the shares of problem earning assets categorized as doubtful or loss, also improved, i.e. declining from 5.3% to 4.2% and from 16.3% to 13.6% respectively. By type of financing, factoring had the worst asset quality, with the share of loss assets reached 63.1%. The best asset quality meanwhile owned by consumer financing, where the share of loss assets was only 1.4%.

(Percent)

Tabel 8.14
Quality of Earning Assets

Productive Assets	2000			2001r			2002 1)		
	C	D	L	C	D	L	C	D	L
Financing :	**69.7**	**7.4**	**22.8**	**78.0**	**5.3**	**16.7**	**82.2**	**4.2**	**13.6**
- Leasing	69.0	12.4	18.6	76.5	7.8	15.7	78.8	6.6	14.6
- Factoring	42.7	4.2	53.1	28.9	6.4	64.7	30.6	6.3	63.1
- Credit Card	66.8	1.5	31.7	75.7	2.3	22.0	94.0	3.6	2.4
- Consumer Financing	94.7	1.6	3.7	96.3	1.7	2.1	97.2	1.5	1.4
Securities	**88.0**	**0.2**	**11.7**	**85.3**	**6.1**	**8.6**	**83.3**	**3.6**	**13.1**
Equity	**97.7**	**-**	**2.3**	**93.1**	**0.2**	**6.8**	**96.9**	**3.0**	**0.1**
Total Productive Assets	**70.6**	**7.1**	**22.3**	**78.4**	**5.3**	**16.3**	**82.2**	**4.2**	**13.6**

L = Current, D = Doubtful, M = Loss
1) November 2002

State-owned Pawn Company

Table 8.13
Financing by Economic Sector

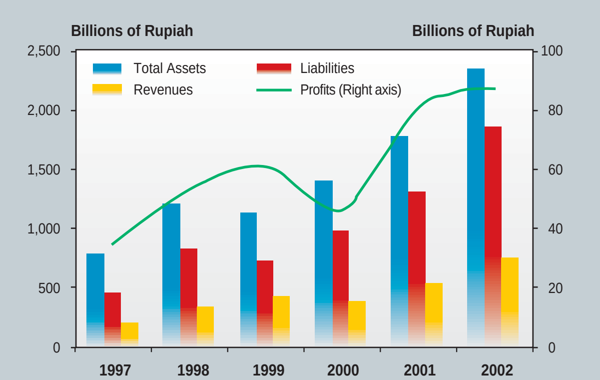
Economic Sector	Financing (Trillions of Rp)			Share (%)		Growth (%)	
	2000	2001r	2002 1)	2001r	2002 1)	2001r	2002 1)
Agriculture	0.7	0.6	0.4	1.9	1.3	-20.9	-26.6
Mining	0.3	0.4	0.7	1.4	2.0	23.3	57.1
Industry	6.3	6.1	5.0	19.8	15.2	-2.5	-17.4
Electricity, Water, and Gas	0.2	0.1	0.1	0.4	0.2	-34.7	-50.4
Construction	2.0	2.0	1.7	6.4	5.2	-0.3	-13.2
Trade	5.1	4.4	4.7	14.2	14.2	-14.7	7.9
Transportation	2.3	2.4	2.6	7.8	7.9	2.5	9.6
Business Services	0.8	0.9	0.9	3.0	2.8	16.3	-1.2
Social Services	0.6	0.6	1.1	2.1	3.3	11.0	72.1
Others	11.0	13.3	16.0	43.1	48.0	20.5	20.2
Total	29.4	30.8	33.3	100.0	100.0	4.9	7.9

1) up to November 2002

The performance of the state-owned pawn company also improved in 2002, as shown by rising total assets, disbursed loans, business revenue and profits earned in the prevailing year. Total assets of the pawn company rose by 31.2%, lending by 31.0%, business revenues by 40.5% and profits earned in the prevailing year by 8.2% from the past year. The improved performance was supported by increases in coverage and service quality through the establishment of new branches and product diversification program (Graph 8.10).

The build up in public's demand for its services as seen in the number of customers that trended larger, has motivated the pawn company to add new branch offices. During 2002, the pawn company has added 31 new branch offices all over Indonesia, bringing the total to 737 branches at the end of the year, which resulted in the higher number of customers served by 11.5% to 17.5 million customers. By composition, most of its customers were traders with a share of 23.2%, followed by farmers of 21.6%, employees of 15.5% and fishermen of 5.8% from the total number of customers (Table 8.15).

In anticipation of intensifying competition in the



Graph 8.10
Performance of State-owned Pawn Company

(Millions of Rp)

Table 8.15
Performance of State-owned Pawn Company

Item	1999	2000	2001[r]	2002[1]
Total Branch Offices[2]	649	659	706	737
Credit Extended	3,229,280	4,230,778	5,970,310	7,823,704
Operational Income	449,087	377,162	552,358	776,203
- Capital Leasing	417,370	341,936	500,562	699,094
- Appraisal Services	16	16	27	42
- Consignment Services	10	11	18	28
- Custody and Insurance	25,319	31,270	47,033	71,827
- Others	6,372	3,929	4,718	5,212
Liabilities				
- Short-term Liabilities	243,612	454,176	480,568	898,737
a. Bank Loans	120,067	157,631	252,363	600,858
b. Promissary notes	60,272	50,000	50,000	105,000
c. Bonds	-	199,710	99,750	64,600
d. Others	63,272	46,835	78,455	128,279
- Bonds	389,556	439,486	636,672	873,060
- Long Terms Liabilities	100,000	105,000	200,000	95,000
- Equity	409,553	415,256	475,614	486,320
Profit/Loss	61,755	46,838	80,851	87,505
Number of Customers[3]	12,427,554	12,982,306	15,692,229	17,490,235

1) Data based on Operational Report December 2002
2) Unit
3) Persons

pawn business, during the year in review the pawn company introduced two superior products, namely *gadai gabah and gadai sharia*. The launching of gadai gabah was a break-through made by the pawn company for the benefit of farmers and to prevent them from borrowing/selling un-hulled paddy before harvesting. In the implementation, the pawn company cooperated with agents as well as KUD as executing parties. Meanwhile, the launching of gadai sharia has the objective to serve customers in need of interest-free loan. This product was expected to make rapid progress and to make extensive contribution, considering that the majority of Indonesians were moslem and that more business applying the sharia principles.

The adding of new branches and product diversification have raised business turnover (lending) of the pawn company. In 2002, the pawn company provided the public with Rp7.8 trillion in lending or 31.0% above the lending made in 2001. This has resulted in significantly higher business revenue of 40.5% to Rp77.2 billion, with the largest contribution coming from its core business, capital leasing, which was 90.1% of the total business revenues. Other activities that made major contribution were collateral and insurance 9.3%. The pawn company higher business revenues and efforts for efficiency have raised its profits earned during the prevailing year. In 2002 the pawn company earned profits of Rp87.5 billion, or rose by Rp6.7 billion (8.2%) from the past year (Table 8.15).

On the funding side, most funds came from the issuance of bonds, in the amount of Rp873.1 billion or 37.1% of the total funds owned. This amount included a rise of Rp236.4 billion or 37.1% above the position in 2001. Based on the improved performance indicators in 2002, during the reporting period the Indonesian Rating Company (Pefindo) gave a rating of A+ (stable outlook) to the bonds issued by the pawn company. Meanwhile, funds obtained from bank lending amounted to Rp600.9 billion or 25.5% from the total funds, significantly higher than Rp252.4 billion in the previous year. Other sources of funds were own capital 20.7%, short-term debts from others than banks 12.7%, and long-term debts 4%.

box

Master Plan for Enhancement of Banking Supervision Effectiveness

Development of banking products as well as their potential problems signal the need to continue strengthening banking supervision, so that effective banking supervision could be established in compliance with international standards. Respectively, the *Basel Committee* released a document titled "*25 Basel Core Principles for Effective Banking Supervision*" in September 1997, which basically provides key principles to be used as guidelines in the framework of strengthening domestic and international financial stability.

As regards bank restructuring, Bank Indonesia has supported the BIS efforts by conducting a self-assessment of its compliance with the *Core Principles* (CP)s. To ensure objectivity, BI also requested IMF assistance in performing a similar assessment. The synergy of these assessments is expected to support the sequencing of priorities and directions of IMF assistance to further enhance bank supervision regulations and procedures. The IMF assessment was finalized in September 2002. It indicated that Bank Indonesia is *fully compliant* with 2 *CPs,* namely CP.1 "*preconditions for effective banking supervision*" and CP.2 "*permissible activities*". As regards the other core principles, Bank Indonesia is categorized as *largely compliant*, *materially non-compliant* and *non-compliant*. This assessment also indicates a need to improve effectiveness in implementation of several Bank Indonesia regulations. However, several core elements of effective bank supervision have been partially undertaken by BI, such as (i) sound and *sustainable* macroeconomic policies; (ii) availability of infrastructure; (iii) effective market discipline; (iv) availability of efficient procedures for the settlement of bank problems; and (v) mechanisms for protection against systemic risks, or a financial safety net.

In order to increase compliance, Bank Indonesia has prepared a master plan for Enhancement of Banking Supervision Effectiveness, comprising efforts to enhance banking regulations and supervision in relation to core principles that are categorized as less than fully compliant. This master plan is to be carried out in an integrated manner with quarterly monitoring. As of the end of 2002, implementation of this master plan had increased compliance with the Basel document. This process will be continued and another independent assessment will be undertaken in due course, to reassess the quality of bank supervision conducted by Bank Indonesia.

Realized Implementation of Master Plan

Level of Compliance	(September 2000)	2002	Description
Fully Compliance	2	2	CP. 1; CP. 2
Largely Compliance	5	10	CP. 3; CP. 5; CP. 6; CP. 14; CP. 15; CP. 18; CP. 21; CP. 22; CP. 24; CP. 25
Materially Non Compliance	16	12	CP. 4; CP. 7; CP. 8; CP. 9; CP. 10; CP. 12; CP. 13; CP. 16; CP. 17; CP. 19; CP. 20; CP. 23;
Non Compliance	2	1	CP. 11

box

Makassar Meeting and Efforts to Develop Small- to Medium-Scale Business

Background

Indonesia's extremely wide geographical span and its heterogeneous population and social structure have led to differences in economic development, particularly between the western and eastern regions of the country. Also, equality issues in development have become increasingly important in strategic discussions of the government's development agenda.

To address this issue, the government through the Economic Coordinating Minister and the State Minister for Acceleration of the Eastern Indonesia Development Region, in coordination with Bank Indonesia, initiated dialogue with related parties. This dialogue is aimed at seeking to accelerate economic recovery and to develop the eastern part of Indonesia. Parties involved in the dialogue (which was held in Makassar from September 8 – 10, 2002) included the central government, regional governments, banks, business community and public figures.

The main objective of this dialogue is to formulate concrete measures to promote development in eastern part of Indonesia. Part of the objectives covers the following:

a. Identification of problems facing banks in providing financial resources to accelerate development in the Indonesian Eastern Region

b. To discuss possible government measures to accelerate the development process.

c. To reconcile various interests under a partnership among different parties to promote investment and real economic growth in the eastern part of Indonesia.

Results of the Makassar Agreement

Under this dialogue agreements have been reached, covering three major areas:

a. Natural Resources (encompassing agriculture, plantations, fisheries in the marine zone, forestry, mining and energy, and living environment):
- To synergize the space utilization of the agriculture sub-sectors such as plantation and forestry.
- To enhance cooperation between regional government, business community and banks in promoting local prime commodities
- To reduce import duties on intermediate inputs for agriculture sector and public infrastructures.
- To widen local government authority in licensing procedure (forestry, plantation, and fisheries sub-sectors).
- To empower coastal fishermen in exploiting ocean resources with knowledge and supporting equipments.
- To eliminate overlapping in managing forestry and mining resources in order to sustain the living environment.

b. Infrastructures covering in land, ocean, and air transportations and communications.
   - To enhance the capacity and quality of roads supporting production lines and to prepare master plans for railroads in Kalimantan, Sulawesi, Maluku, and Papua.
   - To develop regional seaports using a partnership model.
   - To shift air-based distribution centers to the Indonesian Eastern Region and to open pioneering airports and to encourage the establishment of local airline companies.

c. Manpower and Financial Resources covering manpower, finance, banking and cooperatives.
   - To empower former Indonesian overseas workers by utilizing plantation areas, increasing training centers, establishing warehouse certification institutions for export products.
   - To disseminate information on potential local export products using Bank Indonesia website.
   - To promote banking intermediation and access to SMEs financing through local banks, mainly BPR.
   - To provide technical, management and financial assistance to BPR in cooperation with Bank Indonesia.
   - To provide tax incentives to BPR depositors.
   - To revoke overlapping regulations that burden business community and to eradicate illegal taxation/charges throughout the regions.

Programs Adopted by Bank Indonesia

For Bank Indonesia, the Makassar Meeting is a forum to socialize the April 22, 2002 MoU (between the Coordinating Minister for Public Welfare and Bank Indonesia Governor) concerning the poverty alleviation program through the empowerment and development of SMEs. Several agreed activities to be undertaken by Bank Indonesia within the MoU included:

a. To encourage commercial banks and rural credit banks (BPR) to channel more credits to the SMEs in support of poverty alleviation program according to each individual bank's *business plan,* while still maintaining consistency with prudential principles.

b. To monitor and to assess the credit performance to SMEs every three months.

c. To disseminate information on employing potential prime sectors and sub-sectors to small business entity through the Integrated SI-PUK at http://www.bi.go.id.

d. To conduct research on The Basic Economic Potential of Regions (Baseline Economic Survey) and commodities suitable for bank financing (the lending model) offered to small businesses.

e. To conduct training to employees/officials of commercial banks and BPR as regards the financing of SMEs.

f. To equip commercial banks and BPR with adequate legal basis in order to stimulate the expansion of credits to SMEs, while still being consistent with prudential principles and prevailing regulations.

g. To strengthen bank institutional infrastructure in channeling credits to SMEs.

As a follow-up of the meeting, Bank Indonesia also undertook several measures in line with Bank Indonesia's program in support of poverty alleviation including the empowerment and development of the SMEs.

In support of small- to medium-scale businesses, the expansion of banking network, particularly BPR have become increasingly important. Accordingly, a new regulation was issued, governing the establishment of BPR domiciled under the authority of several Bank Indonesia's regional offices. To speed up the process of establishing BPR, the licensing authority formerly assigned to the Bank Indonesia's Head Office has been delegated to Bank Indonesia's regional offices.

To stimulate the expansion of credits to small-scale businesses, a new regulation was issued governing the credit ceiling for small scale businesses under a special treatment. That ceiling was raised from Rp350 million to Rp500 million and for distressed regions such as the provinces of Aceh, Maluku, Regencies of Sambas/West Kalimantan, Kotawaringin Timur/Central Kalimantan, and Poso/Central Sulawesi, it was raised to Rp1 billion. This special treatment also covers the calculation of bank's earning assets quality, which formerly was based upon three factors, namely business prospects, financial condition, and capacity to repay and is now eliminated into merely one factor, namely the capacity to repay.

In addition, Bank Indonesia's assistance in the form of information systems (such as SIPUK, SIABE, and SPKUI) could be accessed through the *website* http://www.bi.go.id.

As regards promoting the real sector, Bank Indonesia initiated discussion meeting for bank officers in charge of credits and small businesses, at Bank Indonesia's Makassar and Bandung regional offices.

Achievements

Aside from the Makassar Meeting, efforts to develop the Indonesia's eastern region seem to be showing favorable results as shown in several banking indicators in the eastern part of the country.

Accumulation of third-party funds by banks in eastern Indonesia through June 2002 amounted to Rp59 trillion, up 3.0% from the position at end-2001. Total credits in that region was recorded roughly at Rp27 trillion, or 8% higher than that at 2001. Similarly, the LDR was 44.83%, higher than the western region and the national average level of 38.5% and 39.4%, respectively.

Credits extended to SMEs through September 2002, expanded significantly, by Rp18.1 trillion or 26.7% over the end of 2001.

Future series of activities, such as the Makassar dialogue, are expected to help reduce inequalities between the eastern and western regions of Indonesia, as parts of the unified Republic of Indonesia.

box

Restrictions on Banks' Purchases of Credits from The Indonesian Banking Restructuring Agency (IBRA)

As part of the bank restructuring and national economic recovery programs (in particular to ease the burden of the state budget), IBRA completed an Asset Sales Program (Program Penjualan Aset Kredit/PPAK).

In support of this program, on September 27, 2002 Bank Indonesia issued regulation number 4/7/PBI/2002 on Prudential Principles in the Purchases of Credits by Banks from the Indonesian Banking Restructuring Agency (IBRA). This regulation is aimed at encouraging banks to repurchase credits from IBRA, while maintaining consistency with prudential principles. Through this regulation, more banks are expected to expand their credits under sound banking principles by incorporating the risk assessment in favor of their future sound performance.

For the assessment and transparency purposes, this regulation covers a series of accounting standards and disclosures, including compliance to submit published reports.

One incentive provided by this regulation is that credits purchased from IBRA shall be classified as "current" for a period of 1 (one) year from the date of purchase. In addition, assessment of the above credit shall be based on the analysis of debtor's cash flow and repayment ability. This incentive is quite appealing since under the former definition, credits can only be classified as "current" on the basis of business prospects, financial conditions and debtor's capacity to repay. Another benefit of purchasing this credit is that the credit is quite collectible and is sold with a sufficiently high discount under a transparent mechanism. Since this credit is classified as "current", banks are allowed to provide only 1% provision of the credit's book value.

Besides this incentive, the regulation contains some restrictions. One of them is a limit on the purchases of credits from IBRA, up to a maximum of 50% of a bank's core capital. The determination of this limitation is aimed at preventing concentration risk to solely a small number of banks, obtaining fair market value for credits sold, stimulating banks to concentrate on new credits so that bank intermediation can recovery fully.

The 50% figure is set based on an assessment and analysis of the banking sector's condition as well as its capability to absorb the offered credits. On this basis, and with the assumption that prices received by IBRA are 25%-30% of book value, credits offered by IBRA could be absorbed, but still within the banks' risk taking capacity. The limitation is given to minimize possibilities of CAR decreases below minimum standards or increases in NPLs, and to pre-empt structural problems from undermining the national banks.

Another restriction on the regulation, is the requirement to recover full purchase value of credits within a 5-year period. This provision is based on the fact that the quality of IBRA credits has not sufficiently improved—in many cases, these are still *non-performing* credits. In addition, most of the credits offered for sale have not been restructured. A time limitation (of 5 years) is stipulated in order to upgrade the quality of these loans, which will strengthen banks' balance sheets. This provision would also provide more incentive for banks to make a thorough analysis before purchasing credits; they would need to calculate the return prospects of the credits over a 5-year period. In this way, credits purchased from IBRA will not distort banks' financial condition over the longer-term.

By means of this regulation, banks can participate in the national economic recovery and still be consistent with prudential banking principles, as mandated in Act number 7 of 1992 on Banking, and its amendment in Act number 10 of 1998.

box

Market Risk Management in Obligations To Provide Minimum Bank Capital

Background

Currently, the calculation of banks' minimum required capital in Indonesia has been substantially based on the 1988 Basel Capital Accord (CA). According to this document, banks are obliged to maintain minimum capital of 8.0% of risk-weighted assets. Along with the growing complexity of banking transactions, this approach is no longer considered adequate, because it is based exclusively on anticipation of banks' *credit risk.* In practice, banks also encounter other forms of risk, such as *market risk* and *operational risk.*

In light of these considerations, since January 1996 the Basel Committee has issued amendments to the CA that adds *market risk* elements to the calculation of bank capital. This provision took effect at end-December 1997 in industrial countries that are members of the G-10. This provision has not been applied in Indonesia due to issues arising out of the financial crisis that began in that year. However, in line with banks' improving performance, greater bank *trading* activities and more integration between domestic and global financial markets, it is now deemed necessary to put in place regulations concerning market risk and bank capital.

Since the beginning of 2002, Bank Indonesia has undertaken an intensive evaluation on this planned regulation, including through discussions with banks and other related parties in the expectation that this regulation would be implemented at the beginning of 2004.

Matters To Be Regulated

The coverage of market risk regulated in the 1996 CA amendments basically encompasses interest rate risk, equity risk, commodity risk, foreign exchange risk and price change risk on options. However, current banking regulations determine restrictions on certain transactions, and banks are already obliged to allocate certain capital amounts for protection against exchange rate and interest rate risks. In contrast to interest rate risk that is calculated against banks' *trading book* position, the calculation of exchange rate risk is made against banks' total portfolios (trading and banking books).

Implication of this Regulation for Bank Capital

When this regulation on market risk becomes effective, capital charges for market risk (multiplied by a weight of 12.5) will be added to total risk-weighted assets, which is the denominator of the CAR calculation. Furthermore, the minimum capital ratio of 8% will continue to apply. Consequently, banks may be obliged to add capital in order to maintain their minimum capital ratio in accordance with the 8% regulation. An Individual bank's CAR may decrease, but it depends on the types of and period of the bank's exposure. In response to this policy, banks are expected to be able to properly manage market risk inherent in all exposures, within banking and trading books.

Banks Subject to This Regulation

In Bank Indonesia's assessment of the regulation, it was realized that not all banks carry out activities that are directly exposed to market risks. Consequently, this regulation on market risk will not be applied to all banks. In this respect, certain criteria must be adopted, such as those already used by several countries in applying this regulation. Accordingly, the approach will be based upon: status as foreign exchange banks; relatively large amounts of total assets; and significant trading positions for private national foreign exchange bank and private national non-foreign exchange banks.

Implementation of the BIS Standard Method

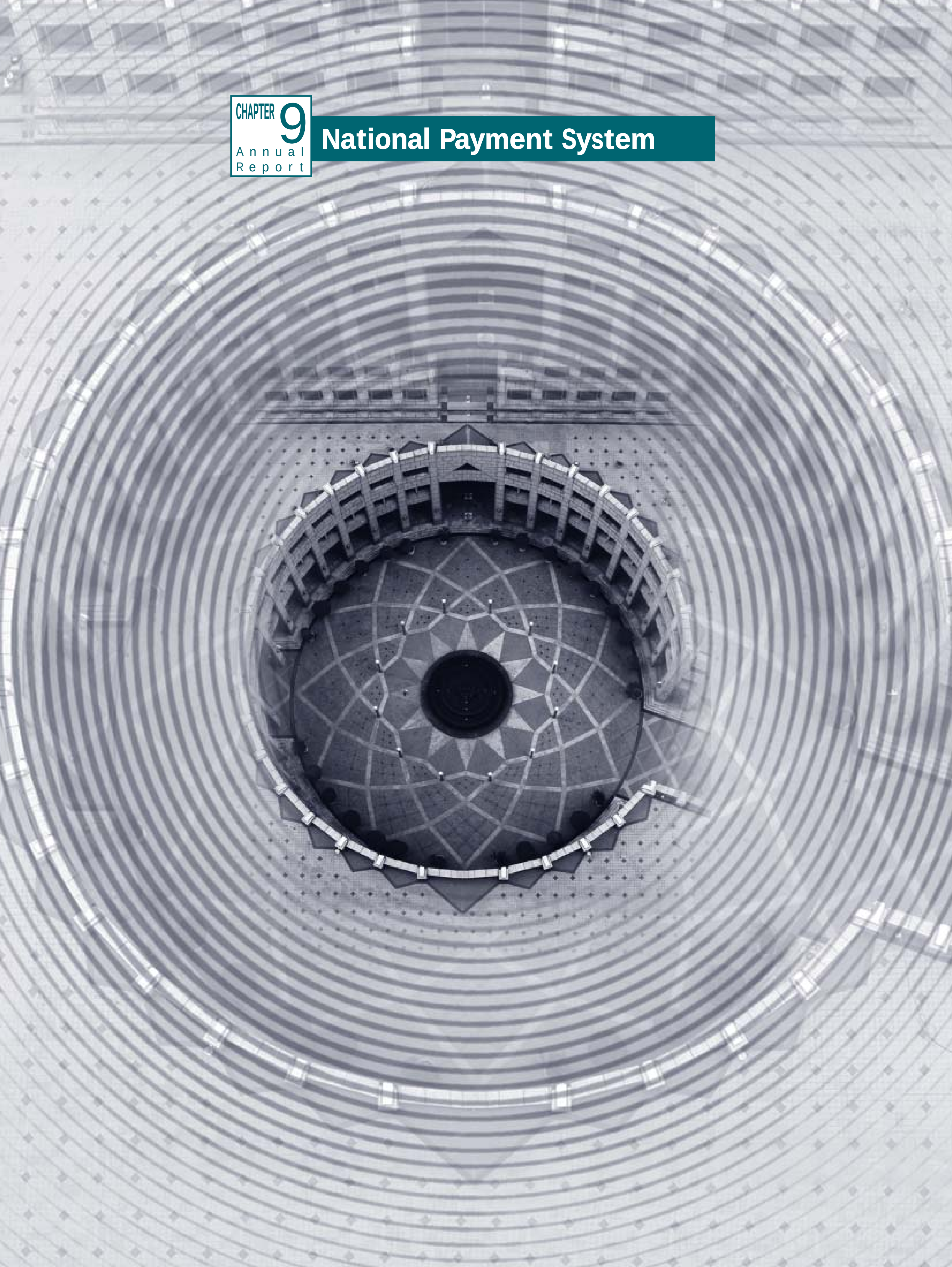
According to the 1996 CA document, there are basically 2 methods for calculating market risk, namely the BIS standard method and an alternative method (*internal model*). As opposed to the alternative method generally adopted by large banks that already have good risk management units and processess; the BIS standard method is simpler. With the BIS method, banks can directly calculate additional capital for covering market risk on their portfolios. Considering current banking conditions, Bank Indonesia temporarily choses to use the BIS standard method. Internal methods can be used by banks for their internal bank management, while waiting for the fulfillment of various quantitative and qualitative factors that will become prerequisites for smooth implementation of internal methods by banks.

Preparations for Implementation

Implementation of the market risk regulation is important for the direction of future banks' preparedness. Therefore, it should be applied cautiously with consideration to banks' readiness. Accordingly, a one-year transition period is suggested in order to give banks a chance to prepare before the regulation is effective. This transition period also prepares Bank Indonesia (and other, related institutions, such as the rating agency) for smooth implementation of its supervisory tasks.

CHAPTER 9 Annual Report

National Payment System



CHAPTER

9 NATIONAL PAYMENT SYSTEM

National payment system policy was focused on reducing payment risks and enhancing efficiency as well as fulfilling real public needs for currency

One of Bank Indonesia's main responsibilities, within the framework of achieving and maintaining stability of the value of the rupiah, is to create an efficient, fast, safe and reliable payment system, which comprises cash and non-cash payments. During 2002 Bank Indonesia took various steps in this area. **In the cash payment system area**, Bank Indonesia adopted policies encompassing three main aspects, namely: fulfilling public needs for currency; ensuring that bank notes were fit for circulation; and minimizing the circulation of counterfeit currency. **In the non-cash payment system area**, policies focused on efforts to reduce inter-bank payment risk and to enhance the efficiency, quality and capacity of payment system services.

In general, payment system activities during the reporting year expanded in line with rising public needs for cash and non-cash payment instruments. Currency in circulation during 2002 grew by 11.8%, down from the previous year's 19.9%. In the meantime, in line with wider implementation coverage of the Bank Indonesia Real Time Gross Settlement (BI-RTGS) system and decrease of the nominal limit (capping) for credit notes processed through the clearing system, non-cash payment activities through the BI-RTGS system rose, while clearing transactions declined. Card-based transactions (such as credit cards, debit cards, and Automatic Teller Machine (ATM) cards) have increased due to expansion of ATM networks and rising consumer financing through credit cards.

PAYMENT SYSTEM POLICY IN 2002

Cash Payment System

To fulfill public needs for currency, policies were mainly directed at the timely provision of currency in fit-for-circulation condition and in sufficient amount (in nominal value and by denomination). As to nominal amounts, Bank Indonesia made efforts to satisfy public needs for currency that continued to rise, particularly with the approach of religious holidays and New Year's. Also, in order to fulfill public needs for bank notes of small denominations, a pilot project has been developed in cooperation with third parties for the distribution of small denominations in Jakarta, Bogor, Tangerang and Bekasi (JABOTABEK) area (Box: Exchange of Small Denominations Through Third Parties). Through this activity, the public can exchange small-denominated bank notes free of charge at exchange booths, which are operated by third parties at public centers.

As a further step in providing currency in line with public needs, Bank Indonesia has improved the calculation method of currency distribution plan (Rencana Distribusi Uang/RDU). Improvements include the addition of more complex and relevant variables, such as seasonal factors, regional characteristics, historical data, and data from the currency demand survey. The improved RDU is expected to provide better guidelines for printing new currency and purchasing raw materials for currency. In parallel, to facilitate the currency distribution process, Bank Indonesia also made efforts to optimize the function of cash depots located in several Bank Indonesia branch offices.

Furthermore, to enhance cash services to the public, Bank Indonesia has implemented the Cash Administration Automation (Otomasi Administrasi Perkasan/OAP) and Currency Circulation Information System (Sistem Informasi Pengedaran Uang/SIPU). This service provides on-line information concerning cash activities at Bank Indonesia.

In 2002, a review on alternative raw metal materials for the composition and standardization of the size of coins has been commenced. The review will examine alternative raw materials with an intrinsic value lower than the face value of the coins, and with a relatively long circulation life. Results of this review are expected to become the basis for future issuance of coins.

With regard to counterfeiting of rupiah, Bank Indonesia has adopted preventive and repressive policies to tackle this problem. The preventive measures include enhanced currency design and additional security features for the printing of new bank notes in denominations of Rp50,000, Rp20,000 and Rp10,000. In addition, a review has been undertaken on the possibility of changing the raw material of Rp100,000 bank notes from polymer-plastic to paper-based materials. Enhanced security features is aimed to assist the public, as the first line of defense, in differentiating counterfeit from genuine currencies because these security features can be seen with naked eye and felt with the fingers.

Other preventive measure involves the dissemination of information on features and easy ways to recognize authentic rupiah currency, through the distribution of posters and stickers, seminars, and public service advertisements on television in cooperation with the Police. Efforts have also been made to enhance coordination with related parties, including members of the National Coordinating Board for Counterfeiting and Forgeries Eradication (Badan Koordinasi Pemberantasan Uang Palsu/BOTASUPAL), and to arrest parties involved in counterfeiting and to bring them to court.

Non-Cash Payment System

With regard to the non-cash payment system, various policies have been undertaken in order to reduce payment risk and to improve efficiency of that system. One of these is wider coverage of the BI-RTGS system. During 2002, the BI-RTGS system (a facility for real-time settlement of payments) was implemented in 15 additional Bank Indonesia branch offices in Banjarmasin, Makasar, Pontianak, Palangkaraya, Jayapura, Ambon, Palu, Kendari, Bandar Lampung, Bengkulu, Mataram, Kupang, Jambi, Banda Aceh and Palembang. Thereby, since the start of the implementation of the system in November 2000 up to end-2002, a total number of 27 branch offices have used the system. With wider coverage of the BI-RTGS system, risks embedded in the payment system, namely credit and liquidity risks, are being minimized.

Meanwhile, in order to minimize payment failure risk originating in inter-bank clearing transaction settlements, a regulation on reducing the nominal limit (capping) for credit notes processed through the clearing system was issued on October 1, 2002.[1] This regulation reduces the nominal limit (cap) from Rp1 billion to below Rp100 million. With this decrease in nominal value, there was a shift of some transaction settlements from the clearing system to the BI-RTGS System.

In line with the above, transaction costs are adjusted both for the clearing system as well as the BI-RTGS system. As regards the BI-RTGS system, rates of transaction costs vary according to the timing of receipt at Bank Indonesia of fund transfer instructions. The costs charged to the banks increase as the timing of receipts get closer to the cut-off time (19.00 West Indonesia Time). The objective is to avoid large numbers of transaction settlements near the cut-off time. With the implementation of new cost rates, it is expected that inter-bank transactions in the BI-RTGS system will be processed more evenly during operating time, which in turn will smooth the payment system and improve banks' liquidity management. In addition, rates went up for inward and outward transactions through the clearing system.

Meanwhile, in order to enhance efficiency and effectiveness of clearing operations, the existing systems and supporting matters need to be standardized. This would be beneficial for accommodating needs related to oversight/ investigation (audit), prompt and accurate provision of data and information on clearing results using web-based facilities (remote access). In this regard, in 2002 an image-based automated clearing system (Image Clearing System/ICS) was installed in the Bank Indonesia branch offices in Bandung and Medan. This system is run using automated clearing note reader-sorter machines, which record data as well as images of clearing notes. In addition, this system is complemented with the provision of information through the Remote Access Clearing Information System and image data storage via a CD Burner.

Further, to accommodate the need for inter-city transaction settlements using cheques/BGs (Bilyet Giro, non-negotiable payment order to account of beneficiary) in all areas in Indonesia, Bank Indonesia has developed an inter-area clearing system known as Intercity Clearing[2] (Box: Intercity Clearing Developments). With the intercity clearing system, clearing operations (which previously could only process clearing notes issued by banks within one local clearing area) can now process cheques/BGs coming from any local clearing area. In addition, the intercity clearing system brings enhancements in time and cost efficiency as regards the processing of clearing notes. Previously this process took some 2-7 days and it now takes the same time as local clearing settlements. The implementation of intercity clearing system began on November 1, 2002 with the participation of 35 clearing banks in all areas in Indonesia.

In support of secure financial markets, Systemically Important Payment Systems (SIPS) must be protected against systemic risks, because failures

1 Bank Indonesia Circular Letter Number 4/12/DASP on Clearing Schedule and Value Date for Final Settlement, System for Local Clearing Operations, as well as Type and Nominal Limit of Notes or Electronic Financial Data.

2 Bank Indonesia Circular Letter Number 4/16/DASP on Local Clearing Operations for Cheques and Bilyet Giros coming from outside Clearing Areas.

in the payment system could disturb domestic and international financial stability. With reference to The Core Principles for Systemically Important Payment Systems developed by the Bank for International Settlement (BIS), Bank Indonesia categorized BI-RTGS System and the clearing system as the SIPS systems. The considerations of such categorization are the large size of the total value of processed transactions; payment characteristics and their impact on domestic and international markets; and the systems' capability to settle financial market transactions and clearing results from other systems.

Within the framework of fulfilling above-mentioned core principles, Bank Indonesia has undertaken a review to evaluate the consistency of the BI-RTGS system and clearing system with the BIS Core Principles for Systemically Important Payment Systems. The review shows that both systems fulfill the core principles as regards system reliability, as well as settlement procedures and assurance. However, as regards regulations and stipulations, risk management and corporate governance, the core principles have not been fully met. To overcome these shortfalls, various improvements and enhancements have been gradually undertaken through policies and improvements to regulations on the payment system area. For example, as regards enhancements in the legal area, a draft of law on funds transfers is currently under preparation. The law will stipulate in detail the rights and obligations of, as well as legal assurance for, all related parties. These enhancements aimed at achieving Bank Indonesia's long run objective to meet all aspects of the BIS Core Principles for Systemically Important Payment Systems.

Various improvements in the payment system area undertaken by Bank Indonesia were very much related to users of the payment system, in particular the banking sector. Each product development of the payment system will have an impact on the banking sector, the direct user of payment system products. Consequently, there is a need for communication and consultation with banking sector representatives of the national payment system. In this respect, in August 2002 the Communication Forum on National Payment System (Forum Komunikasi Sistem Pembayaran Nasional/FKSPN) has been established. The Forum comprises five committees, namely By-Laws, Legal and Consumer Protection, Standard and Procedure, Risk Management, and Information Technology Committees. Synchronization of the needs of all related parties (especially banks) with payment system development is expected to be undertaken within this forum.

With respect to payment system supervision, Bank Indonesia has the responsibility for delivering efficient, fast, accurate and safe payment system services to a wide segment of the public. In this respect, on June 3, 2002, Bank Indonesia established the Payment System Supervision Division. The Division has the authority to issue operational licenses to parties that run activities in the payment system area and to undertake the supervision of payment system operations run by Bank Indonesia and by parties outside Bank Indonesia.

Other notable developments during 2002 included:

- **Preparation of a scheme for overcoming failures in settlement obligations (failure-to-settle scheme)**

Article 16 of Act 23 of 1999 states that one of Bank Indonesia responsibilities is to regulate the interbank clearing system. Currently, final settlements of clearing activities are executed at the end of the day (net settlement), where clearing results are charged on a net basis to participating banks' demand deposits. With end of day settlement, liquidity needs accumulate through the day with the possibility that banks' current accounts will have debit balances. These debit balances must be settled at the latest by 09:00 on the following day; banks that fail to clear their debit balance situation will be suspended from clearing activities.

Based on Act 23 of 1999, Bank Indonesia is obliged to maintain smooth operations of the payment system. Nevertheless, Bank Indonesia is not responsible for banks' shortages of funds that may cause those banks to be unable to settle their clearing results. This is also supported by the Core Principles for Systemically Important Payment Systems. In this respect, Bank Indonesia will adopt a method known as a failure-to-settle scheme, including mechanisms such as cash deposits, pools of collaterals and loss-sharing arrangements.

- **Review of the national payment system blue print**

In developing the national payment system, guidelines are needed concerning policies to create an effective, efficient, safe and reliable payment system. Bank Indonesia's current plans and policies in the payment system area were based on the national payment system blue print issued in 1995.

In the last few years, bank capacity, technology and public needs have been changed. These necessitate a pro-active role on the part of Bank Indonesia to make adjustments to its payment system policies. Also, regional and international cooperation among central banks have colored central bank policies in this area. Such developments are not completely accommodated by the existing payment system blue print. Therefore, the existing blue print is now under review, covering legal, institutional, ownership, safety, efficiency, and risk minimization aspects.

DEVELOPMENT OF PAYMENT INSTRUMENTS

Cash Payment Instruments

Currency in Circulation

Currency in circulation tended to decelerate during 2002. On average, it increased by 11.8% in that year, down from 19.9% in 2001. At the end of December 2002, the position of currency in circulation reached Rp98.4 trillion compared with Rp91.3 trillion at the end of the previous year (Table 9.1).

This lower growth rate in 2002 mainly resulted from a drop in the public's precautionary demand for money in line with improving domestic socio-political conditions. The rise in the amount of currency in circulation in the reporting year stemmed from real growth in the national economy and inflation rate. On a monthly basis, steep rises occurred in the months of November and December 2002, due to public needs for currency with the approach of the celebration of religious holidays and New Year's.

By type of currency, the proportion of bank notes and coins in currency in circulation did not change much during 2002, with shares of 97.8% (Rp96.2 trillion) and 2.2% (Rp2.2 trillion), respectively.

Table 9.1
Development of Currency Position

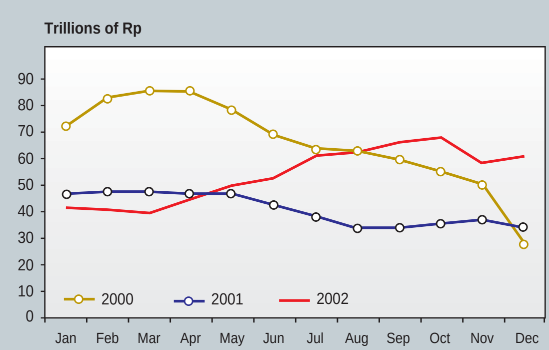
	2001		2002	
	Tota l	Portion(%)	Total	Portion(%)
Currency in Circulation	91.27	100.00	98.42	100
Banknotes	89.44	97.99	96.24	97.79
Coins	1.83	2.01	2.18	2.21

Provision of Currency and Cash Position

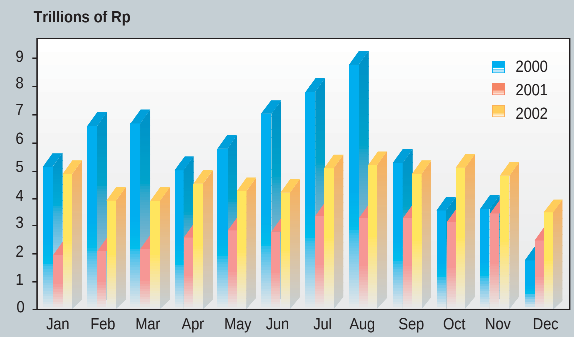
To meet public needs for currency, in 2002 Bank Indonesia set currency distribution plan for delivery of 4.7 billion bank notes (worth Rp86.0 trillion) and 1.6 billion coins (worth Rp316.9 billion). The plan was fully realized during the reporting year. Most of the delivered currency (around Rp54.1 trillion) was to replace currency no longer fit for circulation that has been destroyed and the rest was in anticipation of rising economic needs. In line with the above, Bank Indonesia's cash position at the end of 2002 was quite safe at Rp61.5 trillion, sufficient to fulfill more than 3.3 months of average public demand. This cash position was up by 80.4% from the end of 2001, which was recorded at Rp34.1 trillion (Graph 9.1).

"No Longer Fit for Circulation" Stamping

In addition to providing currency in sufficient amount, Bank Indonesia maintains the quality of currency held by the public through implementation of a "clean money policy". Under this policy, currency that is no longer fit for circulation (known as Pemberian Tanda Tidak Berharga/PTTB) is withdrawn and



Graph 9.1
Development of Cash Position



Graph 9.2
Development of PTTB Currencies

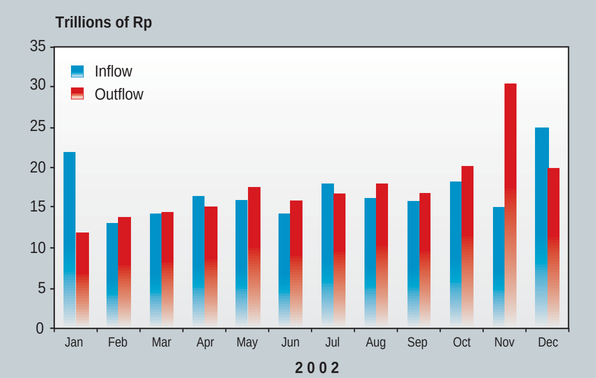
destroyed, and replaced with new currencies. Total PTTB currency in 2002 was Rp54.1 trillion, up 62.3% from the year before, when it amounted to Rp33.4 trillion (Graph 9.2).

In nominal terms, the largest part (56.7%) of PTTB currencies were in the Rp50,000 denomination (worth Rp30.7 trillion), followed by the Rp20,000 denomination worth Rp10.2 trillion (18.9%). By number of notes, the largest part (32.0%) of PTTB currencies consisted of 1.2 billion notes in the Rp1,000 denomination, followed by 612.8 million notes (16.0%) in the Rp50,000 denomination, and 545.4 million notes (14.0%) in the Rp5,000 denomination.

Development of Cash Inflows and Cash Outflows

Cash inflows on a national basis tend to fluctuate markedly. The average monthly cash inflow in 2002 was Rp17.0 trillion, up 9.9% from Rp15.4 trillion in 2001. The average monthly cash outflow was Rp17.6 trillion, up 12.8% from Rp15.6 trillion in 2001.

On this basis, net outflows came to Rp7.3 trillion in 2002, which is a monthly average of Rp0.6 trillion. By area, almost all Bank Indonesia branch offices outside



Graph 9.3
Development of Total Inflows and Outflows

Java experienced a net outflow; those on-Java (except Jakarta) experienced a net inflow. This occurred mainly because most of public spending/expenditure activities are centered on-Java (Graph 9.3).

Development of Counterfeiting

For the period January to December 2002, total findings of counterfeit money (from reports by banks, the Police, and Bank Indonesia) amounted to 370,112 notes (Rp9.9 billion), up from 98,028 notes (Rp3.9 billion) in the previous year. Of that total, most notes were of the Rp20,000 denomination amounting to 288,895 notes (78.1%), followed by the Rp50,000 denomination amounting to 74,514 notes (20.1%), the Rp100,000 denomination amounting to 3,374 notes (0.9%), the Rp10,000 denomination amounting to 2,669 notes (0.7 %) and the Rp5,000 denomination amounting to 660 notes (0.2%). (Table 9.2).

Of total (370,112 notes) counterfeit money, 24,647 notes (6.7%) were found by banks and Bank Indonesia and 345,465 notes (93.3%) were found by the Police. In other words, 24,647 counterfeit notes were actually in circulation; the Police seized most of the rest before they were in circulation.

Non-Cash Payment Instruments

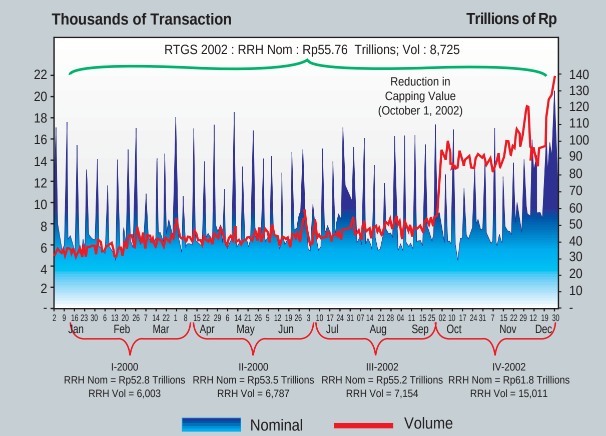
Development of RTGS Transaction

In 2002, activities in the BI-RTGS system expanded significantly, in volume and nominal value. This expansion was in line with wider coverage of the BI-RTGS system, which by the end of the reporting year had been implemented in 27 cities across Indonesia. In addition, the reduction in the nominal limit (capping) for credit clearing notes caused BI-RTGS activity to rise. The daily average of the value of transactions processed through the BI-RTGS in 2002 reached Rp55.7 trillion, up 21.3% from Rp45.9 trillion in 2001. Meanwhile, the daily average volume of transactions reached 8,725, which is up 105.8% (4,239 transactions) from the previous year

(Notes)

Table 9.2
Development of Counterfeit Money Discovery By Denomination

Denomi-nations (Rp)	Findings														
	Quarter - I			Quarter - II			Quarter - III			Quarter - IV			TOTAL		
	Bank	POLRI	Total	Bank	POLRI	Total	Bank	POLRI	Total	Bank	POLRI	Total	Bank	POLRI	Total
100,000	320	1,231	1,551	919	368	1,287	368	18	386	150	-	150	1,757	1,617	3,374
50,000	4.033	56,735	60,768	3,164	42	3,206	3,024	2,736	5,760	4,651	129	4,780	14,872	59,642	74,514
20,000	1.814	272,895	274,709	1,313	53	1,366	996	10,628	11,624	1,196	-	1,196	5,319	283,576	288,895
10,000	256	-	256	426	-	426	370	84	454	1,533	-	1,533	2,585	84	2,669
5,000	27	-	27	40	-	40	28	546	574	19	-	19	114	546	660
Total	6.450	330,861	337,311	5,862	463	6,325	4,786	14,012	18,798	7,549	129	7,678	24,647	345,465	370,112



Graph 9.4
Daily Activity of BI-RTGS In 2002

(Graphs 9.4 and 9.5). Wider implementation of the BI-RTGS system simplifies funds transfer among banks across Indonesia (for large amounts or of an urgent nature). Transfer instructions are carried out without having to go through local clearing or to interface with the internal system of individual banks when branch offices already have BI-RTGS facilities.

Based on nominal value, Bank Indonesia had the largest share of transactions processed through BI-RTGS (Table 9.3). The high value of transactions made by Bank Indonesia was due to the central bank's functions as state treasurer and monetary authority. On basis of

(Percent)

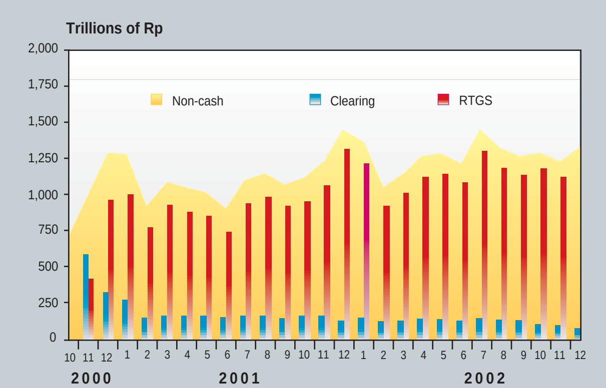
Table 9.3
Share of BI-RTGS Transactions By Participant

Classification	Nominal	Volume
Foreign Bank	13.57	10.13
Joint Bank	2.91	3.59
State Owned Bank	10.33	14.91
Bank Indonesia	55.42	29.27
Regional Development Bank	2.14	3.08
Private National Bank	15.64	39.02

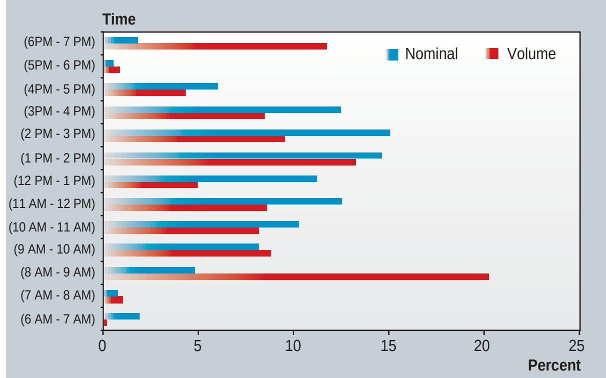
transaction volumes, the national private commercial banks were the most active.

The profile of fund flows generally indicates that: (a) the national private commercial banks have been the most active player in funds transfers (in respect to both money market as well as on behalf of customers); and (b) the regional development banks group have a relatively small role in funds transfer in Indonesia (Table 9.4).

In terms of nominal value, the most active time of transactions processing through the BI-RTGS system was during the morning (between 08:00 to 09:00 West Indonesia Time), mainly due to the high currency deposit and withdrawal activities processed through BI-RTGS system by the banking sector. By volume, the most active transaction time was in the afternoon (between 14:00



Graph 9.5
Non-Cash Payment System



Graph 9.6
Timing of BI-RTGS Usage

(Percent)

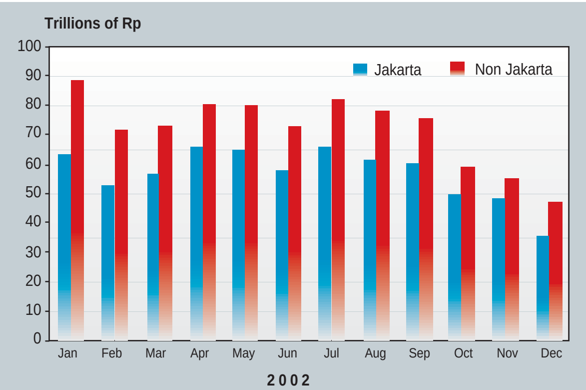
Table 9.4
Map of Inter-Account Funds Flows

Nominal Share		For						Total
		Foreign Bank	Joint Bank	State Owned Bank	Bank Indonesia	Regional Dev. Bank	Private National Bank	
From	Foreign Bank	8.02	1.08	2.22	0.29	0.02	2.73	14,36
	Joint Bank	1.05	0.34	0.33	0.08	0.01	1.06	2,87
	State Owned Bank	2.10	0.29	1.95	1.94	1.26	2.54	10,08
	Bank Indonesia	5.52	2.79	22.16	0.13	3.70	21.80	56,10
	Regional Dev. Bank	0.01	0.01	0.97	0.37	0.37	0.33	2,06
	Private National Bank	3.11	1.19	2.71	0.96	0.27	6.30	14,54
Total		19.81	5.70	30.34	3.77	5.63	34.76	100,00
Volume Share		**For**						**Total**
		Foreign Bank	Joint Bank	State Owned Bank	Bank Indonesia	Regional Dev. Bank	Private National Bank	
From	Foreign Bank	2.28	0.69	2.59	0.30	0.03	4.57	10,46
	Joint Bank	0.66	0.39	0.78	0.24	0.01	1.67	3,75
	State Owned Bank	1.35	0.33	3.26	2.45	1.34	6.16	14,89
	Bank Indonesia	1.52	1.91	5.49	0.25	2.31	18.59	30,07
	Regional Dev. Bank	0.02	0.01	1.15	0.62	0.39	0.78	2,97
	Private National Bank	4.50	1.49	7.47	2.56	0.28	21.55	37,85
Total		10.33	4.82	20.74	6.42	4.36	53.32	100,00

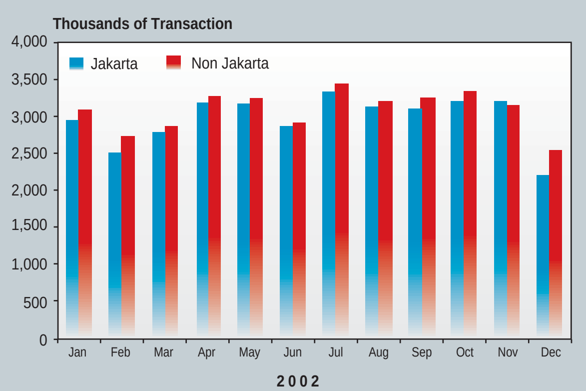
to 15:00 West Indonesia Time), mainly due to high funds transfers on behalf of customers (Graph 9.6).

Development of Clearing Transactions

During 2002, the total nominal value of inward clearing on a national basis dropped by 23.8% from the previous year, from Rp2,035 trillion to Rp1,550 trillion. By contrast, the number of notes rose 1.9%, from 71,616 thousands notes to 72,979 thousands notes. The drop in value resulted from wider implementation of BI-RTGS system and the reduction of the cap on clearing. On an average daily basis, clearing activities in nominal terms



Graph 9.7
Nominal Value of National Clearing

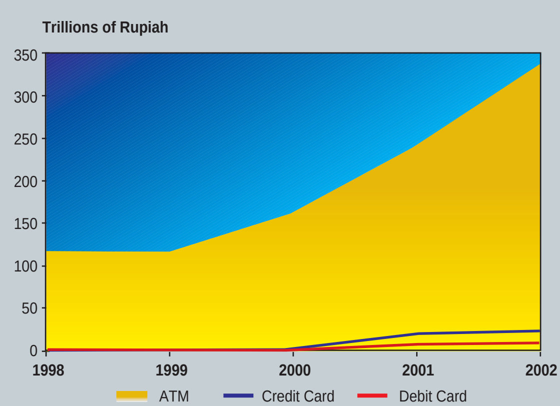


Graph 9.8
Volume of Clearing Deliveries

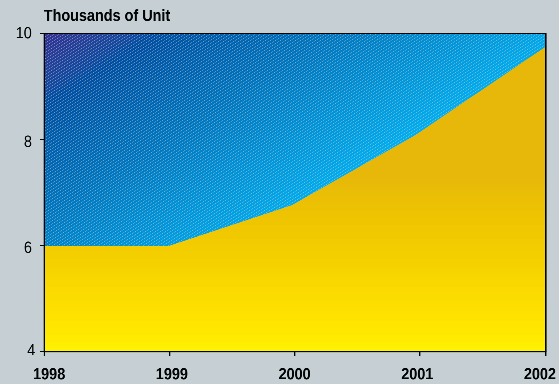
declined by 23.1%, from Rp8.2 trillion to Rp6.3 trillion. In contrast, the average number of notes processed daily was up 10.9%, from 267 thousands notes to 296 thousands notes in 2002. By clearing area, clearing in Jakarta area had the largest share in volume, 49.0%, and a share of 44.0% in value of total national clearing activity (Graphs 9.7 and 9.8).

Development of Card-Based Payment Instruments

In 2002, there was a rise in activity related to the use of card-based payment instruments, namely credit cards, debit cards and ATM cards. Among these, ATM cards had the highest activities, with a total value of transactions of Rp299 trillion or up 44.4% from Rp207 trillion the year before. The rise in payment activity using ATM cards was broadly in line with rising currency in circulation (Graphs 9.9 and 9.10). This rise was further boosted by broadening of the ATM service network, including additional ATM machines, a wider network of merchants that accepted payments through ATM cards, and additional banks offering ATM services. Further in this regard, use of ATM cards that reached a total transaction value of Rp24.2 trillion (or rose by 26.0% from the year before) were related to the expansion in bank credits. For its part, the total transaction value of debit cards reached Rp8.3 trillion, up 25.6% from 2001, indicated that the public preferred to use payment instruments with similar functions and features as the ATM card.



Graph 9.9
Credit Card and Debit Card Transactions



Graph 9.10
Total ATM Machines (in units)

PLANS FOR DEVELOPMENT OF THE NATIONAL PAYMENT SYSTEM

Cash Payment System

1. Enhancement of Currency Circulation Effectiveness through Third Party

a. Distribution of currency in small denominations

In order to satisfy public needs for money in small denominations which is fit for circulation and to accelerate the withdrawal of money that is unfit for circulation, in 2003 Bank Indonesia will continue the distribution of money in small denominations through third parties. The project has been extended to include the head office of BPRs and seven Bank Indonesia regional offices (Box: Exchange of Small Denominations Through Third Parties).

b. Evaluation of Entrusted Cash.

For areas where Bank Indonesia branch offices do not exist, money is distributed through an entrusted cash mechanism in cooperation with local banks. In this respect, in 2003, Bank Indonesia will undertake a review on the effectiveness of using this entrusted cash mechanism.

2. Expansion of Network for Coping with Counterfeiting

To cope with money counterfeiting, in 2003 Bank Indonesia in cooperation with the Police will hold skill training for staff in Bank Indonesia branch offices and the regional Police. Also, to broaden socialization on the features of authentic rupiah notes, in 2003 Bank Indonesia will undertake cooperation with Bank Rakyat Indonesia, which has branch offices down to the village level.

Non-Cash Payment System

1. **Continued Implementation of the BI-RTGS System**

The implementation of the BI-RTGS system, which by end-2002 had begun in 27 Bank Indonesia branch offices, will be widened to include 10 other Bank Indonesia branch offices in 2003, namely in Cirebon, Tasikmalaya, Purwokerto, Solo, Jember, Kediri, Malang, Ternate, Sibolga, and Lhokseumawe. With these steps, in 2003 Bank Indonesia branch offices in all areas will be connected to the BI-RTGS system, allowing implementation of Centralized Settlement Account (CSA). When the BI-RTGS system has been implemented in all branch offices of Bank Indonesia, each bank will only maintain one current account at Bank Indonesia. This will enhance the efficiency of banks as well as Bank Indonesia.

2. **Preparation of Regulations to Reduce Payment System Risk.**

a. Preparation of regulation on the card-based payment instruments

The wider use of card-based payment instruments by the public currently must be supported by comprehensive and explicit regulations, which include legal assurance. In this respect, Bank Indonesia is drafting a regulation which will cover the operations of card-based payment instrument business activities. The regulation will ensure that the products comply with security standards and card holders are provided with clear and accurate information on the products and services.

b. Preparation of Failure-To-Settle Scheme

In 2003, Bank Indonesia plans to request banks' commitments as regards the method to be used in the failure-to-settle mechanism. Tools in this regard include cash deposits, pool of collaterals, and loss sharing.

c. Preparation of Draft of Law on Funds Transfers

In executing its task to regulate and maintain smooth operation of the national payment system, Bank Indonesia has the authority and responsibility to regulate and conduct activities related to funds transfer service and final settlements of inter-bank payment transactions. Currently, the operation of funds transfers is not complemented by regulations, which could protect consumers from various legal problems, including the rights and obligations of all parties and proof instrument for electronic funds transfers. To prevent legal problems from arising, a strong legal basis, in the form of an act, must be prepared immediately.

3. **Review of the National Payment System Blue Print**

Review on the national payment system blue print (which began in 2002) will be continued in 2003. In this regard, Bank Indonesia will undertake consultations and communications with outside parties related to the development of the national payment system, in order to obtain input for improving the blue print. The objective is to synchronize the interests of payment system operators in the development of the payment system in order to create an effective and efficient payment system.

box

Exchange of Small Denominations through Third Parties;

A Solution to Currency Scarcity

Bank Indonesia's main task in the currency circulation area is to ensure the timely provision of currency in amount and by denomination that is adequate to meet the public's needs. It should also be of a quality that is fit for circulation.

The implementation of this task seemed to have shortcomings, as reflected in public perceptions of the difficulty of obtaining small denominations. Where they were available, they were not always in fit condition for circulation.

This experience suggests that the existing currency distribution network—namely, from Bank Indonesia to commercial banks and then from commercial banks to the public—has not always worked properly. Commercial banks, which are expected to be intermediary institutions in meeting the currency needs of the public, are in practice reluctant to deal in small denominations, particularly coins. This is due to limited human resources, vault and transportation capacity, and the regular pattern of customers' needs that normally uses large denominations.

To cope with the current constraints, to improve services to banks and to meet public's needs for small denominations as well as to expedite the withdrawal of currency which is no longer fit for circulation, on December 13, 2001 a pilot project on cooperation program regarding exchange of small denomination was undertaken. Under this program exchanges of small denominations are conducted through third parties so as to serve public needs within the Special Jakarta District. Currently, 5 companies have been appointed to execute the program.

In light of the positive results and enthusiastic response from the public, this cooperation program has been expanded to reach more of the public. Expansion covered areas in Bogor, Tangerang, Bekasi, Karawang, Depok and Serang. The program was begun on September 30, 2002 with the appointment of sixty-nine BPRs in the expansion area.

To date, implementation of the small denomination exchange program (both through third parties and BPRs) is going well. The program is less costly and its coverage is wider than that of the mobile cashiers formerly operated out of Bank Indonesia. Also, the cash division of Bank Indonesia does not need to operate mobile cashiers, allowing more focus on other cash service activities.

b o x

Development of Intercity Clearing

Act 23 of 1999 on Bank Indonesia (BI) states that one of BI's tasks is to regulate and maintain smooth operation of the payment system. Bank Indonesia's plans and policies in the payment system area are contained in the national payment system blue print issued in 1995. According to the blue print, one of the efforts needed to create an affective, efficient, safe and reliable payment system (particularly for inter-regional trade transactions and payments) was the establishment of inter-area clearing operations, known as *intercity clearing* operations. This step was taken on October 1, 2002.

Before the introduction of the *intercity clearing* system, inter-bank clearing was operated locally. Under this system, clearing notes that could be processed included cheques/BGs issued only by bank offices participating in that particular clearing area. Cheques/BGs issued by banks outside the local clearing area had to be processed by inkaso mechanism, through the issuing bank, other banks or correspondent banks.

This situation was unfavorable for banks, public and Bank Indonesia, as it reduced service quality for customers; increased transfer costs; entailed a relatively long settlement period; and led to uncertainty concerning the funds. Overall, it was an inefficient part of the national payment system. To rectify this problem, the *intercity clearing* system was developed, which allows banks to clear their notes with clearing operators in any area.

Development of the intercity clearing system is possible due to the technology owned by banks, which enables on-line verification on out-of-town cheques/BGs. Technically, registration for *intercity clearing* participation needs to be done only once by a bank's head office and is valid for all branch offices of that bank all over Indonesia. With the possibility for each bank to clear cheques/BGs from other cities, banks participating in *intercity clearing* must pay attention to the following matters:

a. Cheques/BGs verification system

The system and procedures for the verification of cheques/BGs are very important, particularly for those issued by bank offices located in other clearing areas. Particularly notable in this context are the security and efficiency of the verification system and the availability of a contingency plan.

b. Clearing notes printing

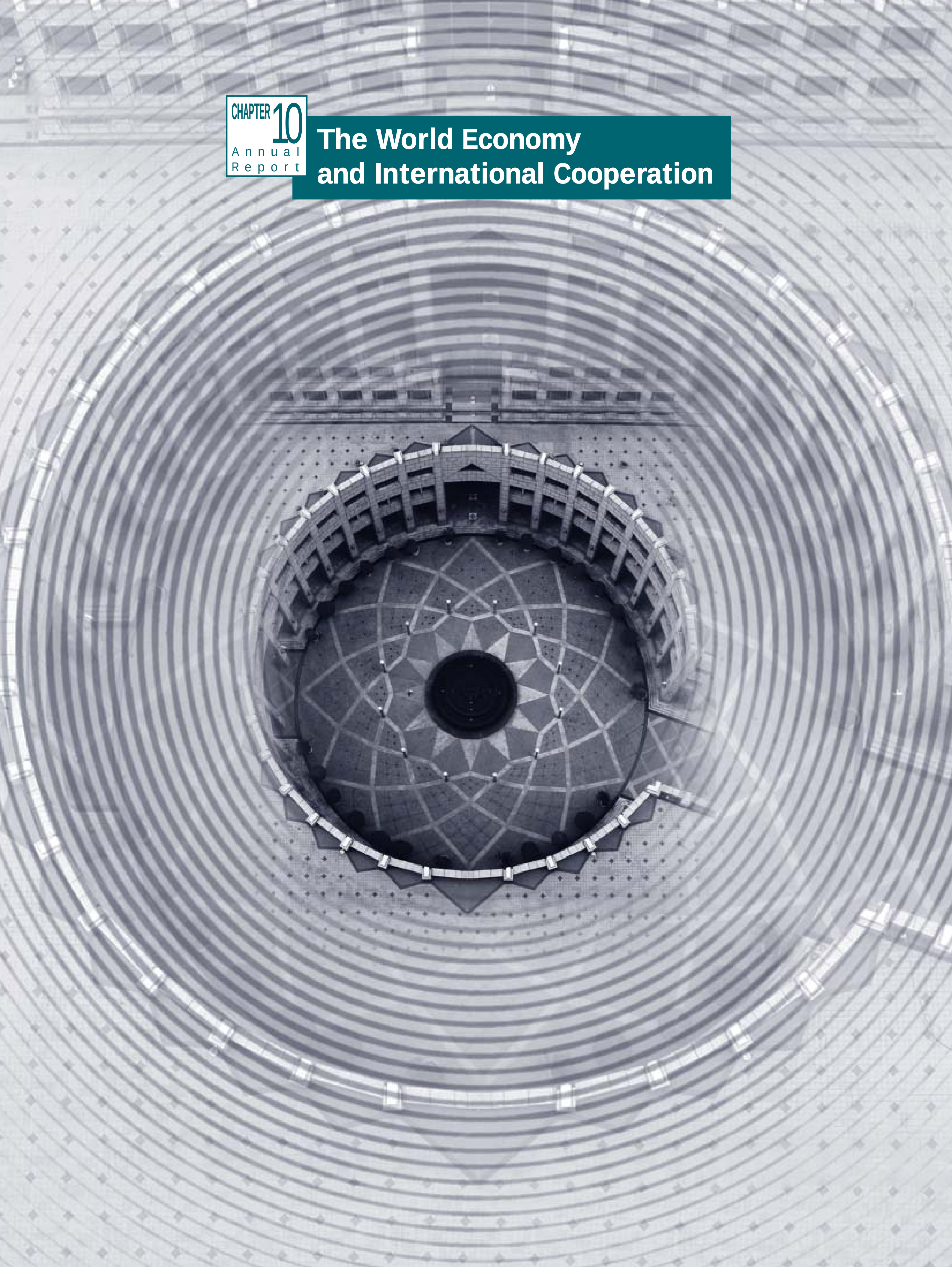
With the implementation of *intercity clearing* system, a participating bank office that wants to clear out-of-town cheques/BGs coming from a non-automated clearing area, where the clear band conditions is still empty, must fill in the following *fields:* office code, the name of issuing bank; account number; transaction code and nominal amount. Therefore, banks must ensure that the clearing notes are printed correctly, whether by banks' head office or branch offices, and in compliance with the standards set by Bank Indonesia.

Meanwhile, from the clearing operator side, implementation of the intercity clearing system obliges the clearing operator to update codes of clearing participants in the application used as the operator. The updating process should be done for each registration, addition or reduction in participation in the intercity clearing system.

Finally, the implementation of intercity clearing is expected to give benefit to public, banks particularly for intercity payment using cheques/BGs.

CHAPTER 10
Annual Report

The World Economy and International Cooperation



CHAPTER 10

THE WORLD ECONOMY AND INTERNATIONAL COOPERATION

Improvement in the world economy during 2002 was mainly supported by rapid growth in Asian countries

During the reporting year, world economic conditions tended to improve somewhat from the previous year, but they remain overshadowed by uncertainty. The improvements include moderately rising world economic growth, an expanding volume of world trade, and declining inflation in various regions.

However, world economic growth was not as high as previously expected, which was attributable to world consumption that remained sluggish due to the influence of high unemployment and uncertain economic prospects. In addition, world stock markets tended to weaken, particularly during the second half, due to financial scandals in large US corporations. World economic developments in 2002 were also marked by rising geopolitical risks, which in turn influenced business and consumer confidence. In an effort to provide stimulus to world economic growth, some industrial countries adopted expansionary economic policies as reflected in declining interest rates.

The precarious situation of the world economy received attention in various international forums. During the reporting year, discussions in international global and regional forums for monetary and financial cooperation continued to emphasize efforts to strengthen the international financial architecture in order to maintain international financial stability. In addition, various international meetings intensively discussed efforts of individual countries to combat money laundering and financing of terrorism. As regards cooperation in the development area, during the reporting year, a joint commitment was reached in the "Monterrey Consensus", which would become a reference for financial institutions and donor countries in relation to programs for growth acceleration and poverty alleviation.

WORLD ECONOMIC GROWTH

During 2002, the world economy grew by 2.8%, up from 2.2% the year before. In line with rising economic growth, the volume of world trade expanded by 2.1%. On the price side, inflation in various regions tended to decline. The inflation rate of developed countries dropped from 2.2% to 1.4%, and that of developing countries edged down from 5.7% to 5.6%. Meanwhile, interest rates trended lower during the reporting year (Table 10.1 and Graph 10.1).

Rising world economic growth during the reporting year was largely supported by an improving US economy, rapid growth in some Asian countries (particularly China and Asia's newly industrialized countries), as well as continuing economic recovery in several other Asian countries.

However, the improvement in world economic growth was still accompanied by relatively low

Table 10.1
Selected World Economic Indicators

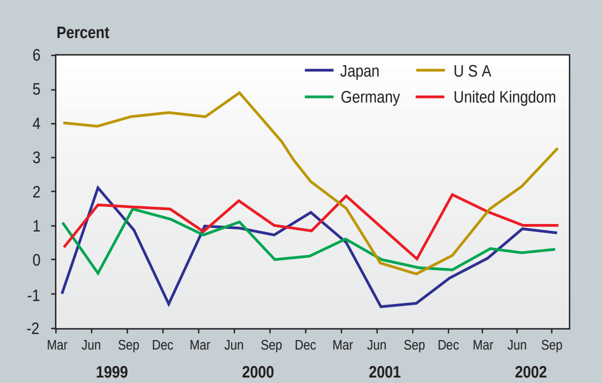
Indicators	2000	2001	2002*
Economic Growth (%)			
World	4.7	2.2	2.8
Industrial Countries	3.8	0.8	1.7
Developing Countries	5.7	3.9	4.2
Countries in Transition	6.6	5	3.9
CPI (%)			
Industrial Countries	2.3	2.2	1.4
Developing Countries	6.1	5.7	5.6
World Trade Volume			
(% growth)	12.6	-0.1	2.1
World Trade Prices			
(% change)			
Manufactured goods	-5.2	-2.3	2.6
Crude oil	57	-14	0.5
Non-oil and gas primary commodities	1.8	-5.4	4.2
Major Exchange Rate			
Yen/$	107.8	121.5	124
$/EURO	0.924	0.896	0.939
Industrial Countries' Interest Rate			
(% average)			
Short-terms	4.5	3.2	2.3
Long-terms	5	4.4	4.2

Source : IMF, World Economic Outlook, September 2002, Bloomberg

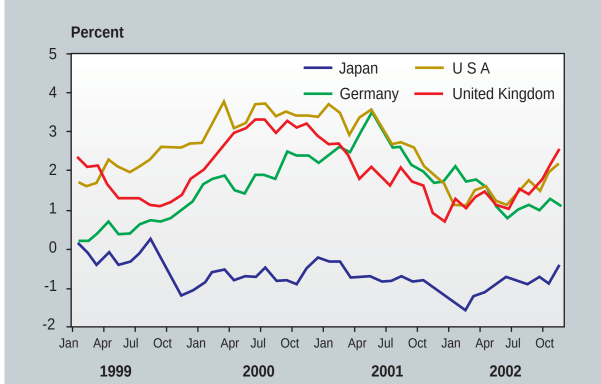
consumption growth in all regions, mainly attributable to high unemployment. The rising trend of unemployment lowered income expectations, which prompted the public to reduce their consumption spending. This had the beneficial effect of holding down inflationary pressures as reflected in declining inflation rates in all regions. Meanwhile, investment remained on a weak trend in line with worries over the possibility of a US attack against Iraq, accounting scandals at large US corporations, and worries over spreading terrorism. Rising oil prices, which for a while reached $31.4 per barrel, put some pressure on world consumption and investment.

World economic policies during 2002 were a continuation of previous years' policies, which tended to be expansionary through both monetary and fiscal policies. These policies were adopted in order to provide a larger stimulus to world economic growth, especially after the first quarter when economic recovery stalled. Loose economic policies were adopted by the major countries that had low inflation rates, such as the US, Japan, and countries in the Euro area. Several other countries (both advanced and developing countries), particularly those that faced threats from inflation, adopted policies to raise the effectiveness and credibility of anti-inflation efforts (Graph 10.3).

In the first semester of the reporting year, stock market developments were marked by growing



Graph 10.1
Major Industrial Countries Economic Growth



Graph 10.2
Inflation in Major Industrial Countries

optimism regarding recovery of the US economy. However, optimism faded in the second half and stock markets turned downwards. The turn was accentuated by deterioration in the US stock markets in line with the slowing US economy, accounting scandals involving large US corporations, and cuts in businesses' profit expectations, which lent a bearish sentiment to the markets. This bearish sentiment spread to stock markets in Europe, Japan, and other bourses around the world.

Although world economic conditions did generally improve, several risks and uncertainties overshadowed the sustainability of economic growth in various regions, especially for the three world economic powers, the US, Western Europe, and Japan. Meanwhile, restructuring of some emerging market countries, particularly in Asia, had not proceeded smoothly, and was still susceptible to external shocks. In addition, the possibility of an attack by the US and its allies against Iraq magnified business risks due to rising uncertainty.

The United States

In the reporting year, US economic growth was estimated to reach 2.2%, substantially higher than the year before (0.3%). This rise was due to a bias towards easing of monetary policies adopted in 2001, including through the reduction of the federal funds interest rate on eleven occasions, from 6.5% at the end of 2000 to 1.75% at the end of 2001.

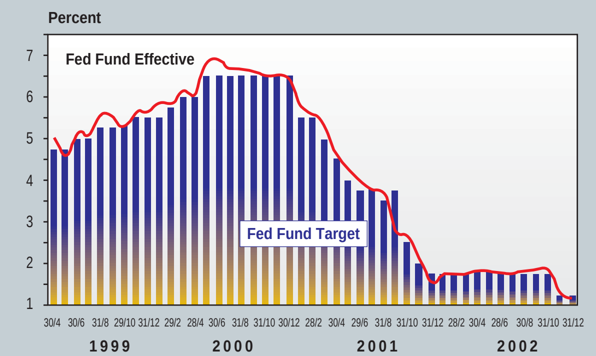
Consequently, in the first quarter of the reporting year, the US economic growth rose sharply by 5.0% (q-t-q). Several indicators confirmed rising economic activity, such as higher output in manufacturing, rising consumption, and declining inventories.

However, in the following quarters, the US economy slowed down, held back by weakening private consumption and domestic investment spending. This was attributable to deteriorating business and consumer confidence in the economic outlook. Declining business activity was reflected in lower manufacturing production orders, utilization rate of installed capacity, and industrial production. Deteriorating business performance resulted in the creation of fewer work opportunities, and many companies were forced to lay off their workers. Consequently, unemployment edged up from 5.7% at the beginning of the year to 6.0% by year end, which held back consumption. Lower consumption was also reflected in other indicators, such as weaker consumer confidence and slower retail sales.

Weak consumption spending pushed inflation down to a low level. For 2002, US inflation is estimated at 1.5%, lower than the previous year's 2.8%. The realize inflation rate in 2002 was substantially below the Federal Reserve's inflation target of 2.5%.

Another indicator that reflected declining US economic performance was financial market performance; the stock market indices declined steadily in line with a depreciation of the US dollar. The weakening stock market and US dollar reflected the negative sentiment arising form financial scandals in several large US corporations, the worry over US attack against Iraq, and prospects of slowing US economic growth. On the external side, the deteriorating economic performance was mirrored in widening trade and current account deficits.

Faced with these unfavourable developments, on 6 November 2002, the Federal Reserve again cut



Graph 10.3
Fed Fund Rate

the interest rate of Fed Funds, on this occasion by 50 basis points to 1.25%. This quite large cut was expected to stimulate consumption and investment (Graph 10.3).

On the fiscal side, the US Government launched a fiscal stimulus package valued at $674.0 billion over a period of 10 years, starting in 2001. For 2002, the fiscal stimulus package was estimated as worth $80.0 billion. The fiscal stimulus package covered, among others, acceleration of tax deductions for new investments, reduction of tax on dividends, and increased unemployment benefits. This policy was estimated to raise the US government budget deficit for 2002 to $158.0 billion.

Euro Countries

In 2002, the economies of countries within the Euro area recorded growth of 1.1%, down from the previous year's 1.6%. Despite the lower growth, movements in the Euro economies were similar to those of the US economy. After recording stable growth in the first quarter, economic performance in this region slowed through year end.

This slowdown in economic activity stemmed from weak performances in exports, investment, and consumption. Slower exports were indicated by declining industrial production and factory orders, due to the weaker than expected recovery in the US, which is Europe's main market. Meanwhile, decline in business confidence indexes indicated businessmen's pessimism over business prospects in the Euro region.

Weakening business activities squeezed companies' profits. In order to reduce losses, many companies laid off workers, causing the unemployment rate to rise to 8.3%. Rising unemployment and gloomy economic prospects lowered consumer confidence and restrained consumers from spending their incomes, which caused consumption and retail sales to decline further.

The slowdown in economic growth had an impact on fiscal deficits, causing them to exceed their mandated limit of 3.0% of GDP in several major countries, such as Germany, France, and Spain. Germany's economic slowdown had an especially large impact on the European union, because it is the largest economy in that group.

Weakening consumption was the main factor in lowering inflation in this region. The inflation rate in 2002 was estimated to have reached only 2.1%, down noticeably from previous year's 2.6%. This still exceeded the European Central Bank's (ECB) inflation target of 2.0%. Higher-than-targeted inflation prompted the ECB to hold interest rates at 3.25% for some time, despite the economic slowdown. However, on 5 December 2002, interest rates were cut by 50 basis points following a decline in Germany's inflation rate in November 2002.

Japan

During the reporting year, Japan's economic contraction deepened, as GDP declined by 0.5% after slipping by 0.3% in 2001. The main source of Japan's deteriorating economic performance was various unresolved domestic structural problems. Unfinished corporate and banking restructuring had a large impact on all pillars of the economy due to a situation commonly referred to as a 'credit crunch'. High delinquent credits in the banking sector put a burden on the balance sheets of banks and other businesses; they also hampered the banking sector's ability to channel credits and business' capacity to earn profits.

The credit crunch phenomenon pushed many businesses into bankruptcy and forced them to cut back on their work force. This pushed Japan's unemployment rate to an exceptionally high 5.5% in 2002, and it is expected to continue rising in 2003. The high unemployment rate and gloomy outlook for the economy further reduced consumption spending.

Japan's weakening consumption further depressed prices in that country. For the past two years, prices have fallen in Japan (a phenomena called 'deflation'); in 2002, deflation is estimated at -1.0%, even lower than -0.7% in the previous year. Price declines have sent many companies into bankruptcy, particularly those that largely serve the domestic market.

Deteriorating domestic demand was a fundamental problem in Japan's economy. Various efforts to date to raise domestic demand have not shown the expected results. Expansionary monetary policies with interest rates near zero (a 'zero interest rate' policy) and the injection of trillions of yen into the financial system have not boosted consumption. The situation was the same on the fiscal side, where the Japanese Government launched several fiscal stimulus packages without significant result.

Weak domestic demand caused Japan's economy to be very much dependent on exports, which is to say, on foreign demand and the exchange rate. In this regard, efforts by the Japanese Government to push exports included policies in the area of the exchange rate. Although Japan's economic prospects were not encouraging, negative sentiment vis-à-vis the dollar during 2002 caused the yen to appreciate against the US dollar, by 9.8%. The yen's appreciation was considered too strong and could have weakened Japan's international competitiveness, which would further harm the Japanese economy. Therefore, the Bank of Japan undertook foreign exchange intervention several times and requested the Fed and ECB to sell their yen reserves in order to restrain the yen's appreciation.

Non-Japan Asia

Improving world economic growth in 2002 was strongly supported by relatively high economic growth of countries within the Asian region. Several Asian countries that experienced high economic growth included China and Laos, which were estimated at 7.5% and 5.5%, up from 7.3% and 5.3% in the previous year. For its part, South Korea was estimated to have experienced outstanding growth of 6.3%, twice the rate of the previous year. The ASEAN economies were estimated to have expanded moderately in 2002, in the range of 3.0% - 4.0%.

The relatively high economic growth of Asian countries was supported, among others, by economic policies that tended to ease, through fiscal, monetary and trade policies. Several countries, such as the Philippines, Malaysia, Thailand, and China, even recorded fiscal deficits due to expansionary fiscal policies. In addition, China adopted a policy that eased capital investment requirements in order to attract more investment. In the cases of South Korea and Singapore, fiscal measures included tariff and tax reductions. Taiwan, Singapore, and Indonesia adopted policies that lowered interest rates.

Relatively expansionary policies could be implemented because inflation rates of the Asian countries were generally moving within low ranges and tended to decline. During the reporting year, the inflation rate of Asia's newly industrialized countries dropped from 2.4% to 1.8%, while inflation in Asia's developing countries dropped from 2.6% to 2.1%.

The slowdown of the world economy and declining demand in major world markets heightened competition in world trade. In general, in order to increase competitiveness, policies adopted were those that maintained exchange rates at attractive levels. In addition, several countries adopted policies that reoriented their export markets from conventional overseas markets (namely the US and Japan) to new markets, particularly countries within the ASEAN region (intra-regional trade).

Despite rapid economic growth, corporate and banking restructuring have not been favourable. Relatively high non performing loans deteriorated the earning assets in those two sectors. In several countries, this has restrained banking intermediation and poses a challenge to the economic prospect in 2003.

Latin America

During the reporting year, the economies of the Latin American countries contracted by 0.6%, worse than the previous year when they increased modestly, by 0.6%. The contraction in 2002 was largely contributed by Argentina, one of the larger countries in that region, which is estimated to have collapsed by some 16.0%, after dropping by 4.4% in 2001. Chile's economy also slowed, to an estimated 2.2%, compared with 2.8% in the previous year. Brazil's economy is estimated to have expanded by only 1.5%, unchanged from last year, while Mexico's economic growth was in the range of –0.3% to 1.5%. In addition to country-specific problems, the decline in economic performance in this region was in line with the continuing weak US economy, the region's largest trade partner. Lower exports caused cutbacks in industry inputs, rising unemployment and a decline in domestic demand.

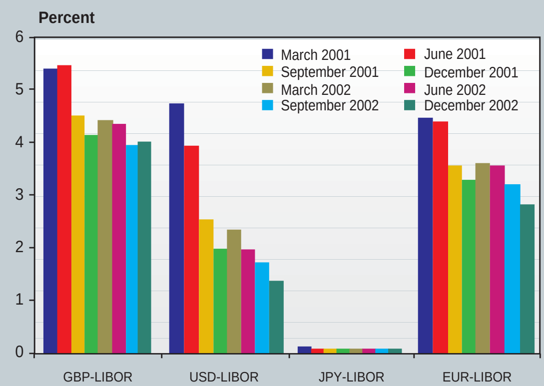
Worsening economic performance was also accompanied by rising inflation, from 6.4% in 2001 to 8.6% in the reporting year. This rise in inflation was largely contributed by Argentina, whose inflation rate is estimated to have reached 29.0%. This high inflation rate in Argentina stemmed from a decline in economic liquidity due to capital outflows, domestic socio-political instability, and exchange rate depreciation. In the first half of 2002, Argentina's Peso depreciated as much as 70.0%, before recovering by about 14.0% beginning in September, prompted by positive signals that the IMF would give more assistance. Unlike Argentina, inflation rates in the three other major countries in that region declined somewhat.

In order to overcome its economic difficulties, Argentina adopted public sector reform and sought to span a recovery in bank intermediation. Brazil adopted pro-growth economic policies, including the implementation of an easing of monetary policy. Mexico undertook more prudent fiscal policies, in line with the Central Bank's monetary policy.

International Financial Markets

The world economy slowed towards the end of the reporting year and financial markets tended to follow the same pattern. Stock indexes in various major world bourses declined in the second half of the reporting year, reflecting worsening business prospects and rising geopolitical risks. Movements of stock indexes were further colored by the slowing US and European economies, financial scandals involving large US corporations, the possibility of an attack by the US and its allies against Iraq, and worries over rising international terrorism. The slump in the US stock bourses spread to stock markets in Europe and Japan, magnified by deteriorating local business conditions, including weak domestic demand, business revenues and profits. Declines in stock prices occurred particularly in companies doing business in the automotive and information technology areas, such as computers and their components.

Decelerating economic activity, particularly in the second half of 2002, accompanied by a declining trend in inflation, put downward pressure on interest rates in money markets in various regions around the world. The 6-month LIBOR rate for the US dollar dropped from 1.98% in December 2001 to 1.38% in December 2002, while the 6-month LIBOR rate for the euro dropped from 3.25% to 2.80% in the same period. Declining economic growth in the second half of the reporting



Graph 10.4
LIBOR

year also put pressure on the central banks of world major countries to lower their benchmark interest rates. In the fourth quarter, the Federal Reserve and ECB lowered their key interest rates by 50 basis points, from 1.75% and 3.25% to 1.25% and 2.75%, respectively. Likewise, in the non-Japan Asian region, interest rates tended to move on a downward path, albeit in various amounts and with different timing (Graph 10.4).

Meanwhile, the US dollar depreciated against almost all world major currencies, particularly the euro and yen. The slowing US stock market stemmed from an uncertain US economic outlook, financial scandals, and worries over US attack against Iraq has raised the risks in dollar denominated assets. This in turn has caused investors to release their dollar denominated assets and reduced the demand for dollars. In line with the yen's appreciation against the dollar, other Asian currencies also tended to strengthen. During the reporting year the rupiah was Asia's best performing currency.

International Commodity Markets

After reaching their cyclical lows in 2001, prices in international commodity markets rebounded in 2002.

In general, commodity prices increased in line with rising world trade volumes and improving world economic growth. However, each commodity experienced varied movements during the reporting year.

Crude oil experienced a steep price rise during the reporting year. The steep upward trend of world oil prices was mainly due to three factors: (i) rising demand in line with the improving trend of the world economy; (ii) worry over the possibility of a US attack against Iraq, which could disrupt the world's supply of oil; and (iii) social turbulence in Venezuela, one of world's major oil producers, at the end of 2002. These factors caused world oil prices to rise well above OPEC's target of \$22.0-\$28.0 per barrel. Brent crude oil prices even surged to \$31.4 per barrel, the highest price in 2002. On a point-to-point basis, in 2002 world oil prices rose 55.0%, from \$19.3 per barrel to \$29.9 per barrel.

In general, prices of non-oil/gas commodities also rose during the reporting year. Factors that provided the backdrop for this rise included rising demand in line with improving world economy. On the supply side, commodity supplies during the reporting year tended to be stable as reflected in sufficient levels of world stocks.

In another notable development, one of world's major non-oil/gas commodities, gold, experienced a sharp price hike during the reporting year, in line with the slump in the international stock markets and the weakening US dollar. The sluggish trend in the stock markets raised the attractiveness of gold as an alternative form of investment. Similarly, the weakening of the US dollar caused the price of gold (which is traded in US dollar) to be cheaper in local currencies, thus prompting a rise in demand for this precious metal. Furthermore, heightened tensions over the situation in the Gulf region caused a surge in demand for gold, because it is seen as a safe form of investment. During the reporting year, the world gold price rose 25.0%, from \$278.9 per troy oz to \$348.1 per troy oz. At one point, it even reached \$349.7 per troy oz.

INTERNATIONAL COOPERATION

During the reporting year, discussions in various international and regional monetary and financial cooperation forums continued to emphasize efforts to strengthen the international financial architecture. In addition, various international meetings intensively discussed efforts by individual countries to combat money laundering and the financing of terrorism. As regards cooperation in development, a joint commitment was reached on the "Monterrey Consensus", which would become a reference point for financial institutions and donor countries in relation to programs for growth acceleration and poverty alleviation.

Cooperation in Monetary, Financial, and Banking Areas

International Financial Architecture

During 2002, various financial institutions, including international and regional cooperation forums, continued efforts to strengthen the international financial architecture and to increase international financial stability. These efforts were realized through the strengthening of surveillance to prevent crises and to increase the private sector's involvement in crisis prevention and resolution. In the ASEAN region, efforts to increase regional financial stability was one outcome of the commitment of ASEAN countries' leaders in achieving the Asian Vision 2020, which had been formulated into the Roadmap for Integration of ASEAN (RIA).

Surveillance

The crises in Asia and Latin America have prompted various international institutions (such as the IMF, ASEAN, ASEAN+3, and the ADB) to strengthen the effectiveness of surveillance with a view to reducing the possibility of future crises. In addition to routine monitoring conducted by the IMF on its member countries (known as Article IV Consultations), several international forums (such as the G-20) also monitored fulfilment of international standards and codes by countries. One example is the IMF program "Reports on the Observance on Standards and Codes (ROSC)".

As a result of the review in April 2002 under the surveillance program, the IMF expanded its surveillance coverage beyond monetary, fiscal, and exchange rate developments. Its monitoring now includes an assessment of external susceptibility; analysis of the sustainability of foreign debts; susceptibility of the financial sector; and structural and institutional policies. This expansion in coverage was in line with changes in the global situation as well as expansion of international capital flows.

At the regional level, surveillance was increased through the ASEAN+3 informal policy dialogue. There were also joint efforts by ASEAN in cooperation with the ADB to set up an early warning system against possible crises.

Private Sector Involvement In Crisis Prevention and Resolution

Efforts to prevent and overcome crises, particularly financial crises, have received widespread attention. Involvement of the private sector in preventing and overcoming crises was meant to share the burden of crisis resolution equally with the government sector, to strengthen market discipline, and to increase the capability of emerging market borrowers to protect themselves from volatility and contagion effects. Efforts in this regard included increases in transparency, privatisation, good corporate governance, settlement of standstill debts, and establishment of a sovereign debt restructuring mechanism (SDRM).

SDRM

Burdensome government debt had been experienced by many developing and transitional countries, such as the Latin American countries, Turkey, and Russia. Reoccurrence of debt crises in several countries has prompted international institutions to seek alternative solutions. Restructuring of governments' foreign debt is one alternative in this regard, to help overcome foreign debt crises and to benefit lenders, borrowers, and the economies of the borrowing countries. In implementation, achieving agreements on foreign debt restructuring has often been difficult and prolonged. One of the main problems was the difficulty in guaranteeing collective action among the lenders in agreeing to results of the negotiations. Often lenders focus on their individual interests and try to get a free ride in the hope of getting repaid in accordance with the original contracts.

Against this backdrop, the IMF put forward a proposal to establish a sovereign debt restructuring mechanism (SDRM). This would be the framework for balanced foreign debt restructuring in order to recover sustainability and growth, without increasing the risk of defaults. This concept was agreed upon by the International Monetary and Financial Committee in April 2002 to be developed as part of the IMF's efforts to improve crisis management.

SDRM is designed to facilitate sovereign debt restructuring for IMF member countries that face unsustainable debt problems, through the framework of collective action by the lenders. SDRM aims to make the restructuring process more orderly, measurable, and timely. SDRM also gives protection to the lenders' asset values and rights. The ideal concept of SDRM aims at the achievement of balanced and proper incentives both for governments as borrowers as well as for the lenders. If the SDRM concept can be successfully designed and properly implemented, restructuring costs for both borrowers and lenders are expected to fall.

Types of debt that can be included under the SDRM initiative include government foreign debts originating from private lenders under international laws, such as eurobonds and syndicated bank loans. SDRM does not cover government formal debts from other governments (currently handled by the Paris Club) and international financial institutions; government debt instruments held by international financial institutions; government debts governed by domestic laws (government domestic bonds); and claims on the private sector, including claims on the banking system.

The SDRM concept is designed to give more attention to the interests of developing countries. In this regard, it needs to be continuously reviewed in order to be more relevant for financial crises occurring in developing countries, specifically as regards the possibility of expanding its coverage of government foreign debts. Difficult discussions at the international level are on-going, such as in the IMF's executive board meetings, G-20 meetings, and the Manila Framework meetings. These discussions include formulation of the framework under international law, and determination of the voting mechanism and other technical issues.

Roadmap for Integration of ASEAN (RIA)

During the ASEAN summit conference of November 2001 in Brunei, the leaders of the ASEAN countries issued the Roadmap for Integration of ASEAN (RIA) as the umbrella for ASEAN economic agreements and initiatives leading towards ASEAN integration in 2020. RIA has three main pillars, namely: (i) bridging development gaps; (ii) deepening economic cooperation; and (iii) increasing economic integration.

In the financial and monetary areas, RIA spelled out 4 main issues, namely: (i) development of ASEAN capital markets; (ii) liberalization of the services sector; (iii) liberalization of capital accounts; and (iv) establishment of an ASEAN currency and exchange rate system. During the reporting year, several initiatives were proposed and several studies conducted to support the liberalization process. For example, a study on the suitability and preconditions for the establishment of an ASEAN common currency, as well as initiatives in the development of a regional Asia bond market.

Establishment of an ASEAN Common Currency

One of the preparations towards the integration of ASEAN currencies is the undertaking of a study on the suitability and preconditions for the establishment of a common currency. The ASEAN Currency and Exchange Rate Mechanism Task Force started the study in mid-2001. The Task Force completed its study and presented the results at the ASEAN Central Bank Forum in October 2002. The analysis shows that the idea to establish an ASEAN common currency cannot be realized in the near future, considering that there are large economic gaps between the ASEAN countries. Such limited economic convergence of the ASEAN countries makes a common currency infeasible. ASEAN does not yet have a lead country whose currency could serve as an anchor for the regional exchange rate mechanism. Furthermore, the level of ASEAN intra-regional trade is relatively low compared with total international trade of the ASEAN countries. Moreover, ASEAN political commitment is still dominated by the national interests of each member country. ASEAN countries need to have a strong political commitment as well as sufficient time to reach at least near-convergence of their economies. This would avoid conflicting interests when adopting common regional fiscal-monetary policy as monetary integration is being established.

Up to the present, the Asian bond market has not been popular among investment managers, because they prefer bonds with higher ratings. However, the latest developments—especially rising international reserves of the ASEAN countries and the desire to obtain higher yields and more diversified portfolios—have created room for further development of the Asian bond market. The initiative to develop the Asian bond market originated in the informal meeting between central banks and finance departments officials of the ASEAN+3 countries in Chiang Mai, Thailand, in December 2002. The objective of this initiative is to promote an efficient and liquid Asian bond market so that the private and public sectors in Asia can invest in long-term capital without currency risk and maturity mismatches. The Asian bond market would replace foreign loans and thereby: (i) provide stable long-term funding for the private and public sectors by utilizing Asian countries' savings; (ii) strengthen regional financial systems with the provision of various alternatives for transferring savings into capital investments within the region; and (iii) prepare the foundation for sustainable economic growth by upgrading the regional financial sector.

To this end, a conducive environment for the development of a regional market needs to be created through a comprehensive approach. The necessary steps would include: (i) improving infrastructure for the Asian bond market by strengthening the regional rating system, improvement of the regional settlement mechanism and creation of a due diligence process and short-term regional financial arrangements; (ii) providing credit enhancement by utilizing structured financial techniques to help small-to-medium scale enterprises access the Asian bond market as well as increasing market efficiency and liquidity through the provision of market making arrangements and issuance of government bonds as benchmarks in the market; (iii) facilitating market development through technical assistance from advanced countries, information dissemination on the financial profiles of well-performing companies within the region and on the economic situation and other conditions within the regional bond market.

In order to increase yields while promoting development of the Asian bond market, at the EMEAP (Executive Meeting of East Asia Pacific) Working Group on Financial Markets meeting of June 2002, the Hongkong Monetary Authority (HKMA) advanced the idea of establishing an Asian Bond Fund (ABF).[1] In the November 2002 meeting, the EMEAP deputies basically supported the idea of establishing the ABF. However, various improvements and agreements on some aspects of ABF are still needed. Indonesia appreciates the efforts to establish the ABF and believes that investments in the ABF will be beneficial for the development of the Asian bond market. However, there are several issues that still need to be discussed, considering that Bank Indonesia has conservative investment guidelines that do not allow investments involving the corporate sector. Also, investments in the ABF would include investment in the related country's own bonds, while investments in own-country securities are not included in the calculation of Net International Reserves (NIR). Consequently, such investments in the ABF would reduce total NIR.

Bilateral Swap Arrangements

During the Fourth ASEAN Finance Ministers Meeting (AFMM) in Brunei Darussalam on 24-25 March 2002, ASEAN's Finance Ministries agreed to extend the membership of the ASEAN Swap Arrangement (ASA) covering all ASEAN countries and including more countries in the region, namely China, Japan and Korea. As a follow up, during the Special ASEAN Finance and Central Bank Deputies Meeting (AFDM) on 6 May 2000 in Chiang Mai, Thailand, the ASA extension proposal was activated through the Chiang Mai Initiative. One of the agreements is the expanded Bilateral Swap Arrangement (BSA) among ASEAN countries +3 (China, Japan and Korea). BSA is aimed at providing short-term financial assistance in the form of swap arrangements to member countries under the Chiang Mai Initiative. This swap facility constitutes a supplementary financing facility provided by the IMF and ASA in view of overcoming the balance of payments imbalances of the member countries. The benefits of BSA including : (i) promotion of close cooperation in the financial sector among ASEAN plus 3 countries (Korea, Japan and China); (ii) the BSA facility could be used as an alternative balance of payments support; (iii) there is no commitment fee at the time the BSA is signed. Hence there would be no fee charges prior to the withdrawal of funds.

Following the approval of main principles during the Fifth AFMM in Kuala Lumpur on 8 April 2001, each ASEAN country negotiated bilaterally with the +3 countries. Up to the AFMM+3 forum at Shanghai on 10 May 2002, those who signed the BSA including Japan-Korea, Japan-Thailand, Japan-the Philippines, Japan-Malaysia, China-Thailand, and China-Japan. The negotiation is ongoing between China-Korea and Korea-Thailand (end stage); Korea-Malaysia and Korea-the Philippines (negotiated); Japan-Singapore, China-Malaysia, China-the Philippines and Indonesia-Japan (ongoing negotiation). The BSA between Indonesia and Japan is scheduled to be signed in February 2003.

1 The Asian Bond Fund will be an investment pool (comprising a combination of bonds issued by the Asian countries) managed by an investment manager. Each central bank that wants to participate would allocate a small part of its international reserve for this purpose. Participation of the EMEAP countries' central banks in the ABF would be voluntary.

The New Basel Capital Accord

During the reporting year, various cooperation forums (such as the central bankers' EMEAP and SEACEN (South-East Asian Central Banks) and the finance departments' "Manila Framework") intensively discussed the New Basel Capital Accord [2] proposal. Of special interest was the concept and readiness of the developing countries' banks in Southeast Asia to follow the implementation schedule of this new regulation.

In principle, the New Basel Capital Accord increases banks' risk sensitivity in undertaking business activities. It contains three basic innovations, namely: (i) complementing current quantitative standards with two additional pillars in relation to supervisory review and market discipline;[3] (ii) allowing banks that have good risk management capability to use their own internal systems to undertake credit risk evaluation (known as internal rating based (IRB) evaluation); (iii) making it possible for banks to use grading systems of private rating institutions by classifying their foreign claims into five risk groups and their claims on the corporate and banking sectors into three risk groups. Risk calculation in the new concept is widened, by not only covering credit risk and market risk as stated in the Basel Capital Accord I, but also by covering operational risk.

During 2002, this proposal was modified several times based on inputs from various parties, including views of central banks and finance ministries of developing countries. The Capital Accord is scheduled to be issued in October 2003 and implemented at the end of 2006. Implementation of the new Basel Accord is only obligatory for members of the Bank for International Settlements (BIS).[4] Implementation of the Capital Accord will be controversial for developing countries. On one side, if all banks in a developing country can apply the new regulation, confidence in that country's banking system would rise and the economy would get real benefits from fulfilment of this regulation. On the other side, enforcement of this regulation in a time when the banking sectors in developing countries are not ready, including in Indonesia, could hamper bank restructuring and could even cause some banks to be closed. This could endanger national economies.

Anti Money Laundering and Countering the Financing of Terrorism

Anti Money Laundering

Internationally, particularly among the advanced industrial countries, a consensus has emerged that the eradication of money laundering must become a priority commitment of all countries. Those engaged in criminal and terrorist activity make use of money laundering with negative consequences for global security and legitimate economic activity. Greater attention has been given by international institutions (such as the IMF and the World Bank) and international cooperation forums have been established to increase efforts in this regard. These include: (i) the Financial Action Task Force on Money Laundering (FATF) established by the

2 The Basel Accord II was proposed by the Bank for International Settlements in June 2001 to replace The Basel Capital Accord, which was first published in 1988 and then amended in 1996.

3 The New Basel Accord consisted of 3 major pillars in order to strengthen and rehabilitate the banking system. The first pillar concerns minimum capital requirements. The second pillar concerns the supervisory review process, which needs supervisors to ensure that each bank implements good internal process in order to evaluate its capital sufficiency based on careful risk evaluation. The third pillar concerns the promotion of market discipline through increased transparency in bank management.

4 Indonesia is not yet a member of the BIS.

OECD countries; and (ii) the Asia Pacific Group on Money Laundering (APG) established by countries within the Asia Pacific region.

One result of anti-money laundering efforts already achieved by the international forums was the determination of international standards for money laundering prevention and eradication by the FATF, with 40 recommendations. The FATF also undertook reviews of countries that were considered susceptible to money laundering activities by using as a reference the 25 criteria of Non-Cooperative Countries and Territories (NCCT's). The APG undertook assessments of systems for handling money laundering in its member countries and provided cooperation on the handling of money laundering within the Asia Pacific region, including efforts in capacity building. Meanwhile, international institutions, such as the World Bank and the Asian Development Bank, incorporate the issue of money laundering into their requirements for loan disbursements.

International efforts through these institutions were intensified and linked to efforts to eradicate the financing of terrorism. Efforts by advanced countries through these international forums put pressure on developing countries, such as Indonesia to adopt anti money laundering laws and regulations up to international standards.

Eradication of Terrorism Financing

After the WTC tragedy on 11 September 2001 and various other terrorist attacks around the world, many international forums made efforts to handle various issues related to terrorism. Following up the G-20 summit meeting in Ottawa in 2001, G-20 member countries promised to cooperate with international financial institutions. The FATF, Financial Stability Forum (FSF), and other international institutions are concerned with the prevention of misuses of financial systems and threats against financial system integrity. They seek to enhance international standards related to terrorism financing, money laundering, as well as financial sector regulation and supervision.

Within the framework of ASEAN and APEC, the issue of terrorism was included in the discussion agenda for member countries. In July 2002, Indonesia together with other ASEAN countries in the ARF signed an agreement on the eradication of terrorism with the US. Meanwhile, in the same month, Indonesia together with the Philippines and Thailand established a tri-lateral agreement to eradicate terrorism. During the APEC meeting in Los Cabos in October 2002, APEC economic leaders discussed the economic impacts of terrorism; APEC's efforts to combat terrorism and planned actions; the concept of trade security within the APEC region (STAR); and a cyber security strategy.

In line with this, the eighth ASEAN summit meeting in Phnom Penh in November 2002, reconfirmed its stand to implement the ASEAN Declaration on Joint Action to Counter Terrorism, as had been adopted in the ASEAN meeting in Brunei Darussalam in November 2001. The ASEAN countries intended to increase efforts to prevent and eradicate terrorism individually as well as jointly with a work plan as agreed in the Special Ministerial Meeting on Terrorism in Kuala Lumpur, May 2002.

In relation to the WTC tragedy, the Indonesian government welcomed issuance of the United Nations Security Council's Resolution number 1373 dated 28 September 2001 and confirmed its stand to implement the contents of the resolution as a national policy priority. As regards the Bali tragedy on 12 October 2002, the Indonesian government and law enforcement parties in cooperation with other countries tried their best to investigate and arrest the criminals responsible for the bombing. As the execution of the United Nations Security Council's Resolution number 1373, the government under the coordination of the Foreign Affairs Department established a related inter-departmental technical coordination forum to discuss the Indonesian government's joint steps. The government submitted two formal reports to the Counter Terrorism Committee (CTC) of the United Nations Security Council in November 2001 and June 2002, which contained explanations on regulations and steps that had been undertaken or were being undertaken by the Indonesian government. The government also submitted a report, which specifically explained implementation of "Know Your Customer Principles" within the Indonesian banking sector as stipulated in Bank Indonesia's regulations number 3/10/PBI/2001 and number 3/23/PBI/2001. In addition, the government also issued the Law Replacing Government Regulation number 1 of 2002 dated 18 October 2002 concerning Eradication of Terrorist Criminal Actions. This regulation was the realization of strategic policies and steps to strengthen public order and safety by abiding in rule of law and preserving human rights.

Cooperation in Development Areas

Poverty alleviation remained a priority of developing countries. Therefore, the IMF and World Bank together with other members of the international public have a responsibility to assist developing countries, not only in economic development but also in developing the capacity and resources needed to implement their development programs. In this regard, during the reporting year, a joint agreement was reached in the "Monterrey Consensus", in addition to poverty alleviation programs that had previously been undertaken (such as the Highly Indebted Poor Countries (HIPC) Initiative and the Poverty Reduction and Growth Facility (PRGF) program).

The Monterrey Consensus

On 18–22 March 2002, an international meeting was held in Monterrey, Mexico, with the objective of reaching world agreement on poverty alleviation and the achievement of sustainable economic growth within the effort to reach a just global economic system. During this meeting, world leaders stated their commitment to increase cooperation and unity in countering poverty with a target of cutting the incidence of world poverty in half by 2015.

This "Monterrey Consensus" basically states the importance of increasing cooperation between advanced countries and developing countries in order to support development efforts within globalization, which increases interdependence among all countries. As the basis for increasing cooperation, on one hand, the developing countries need to improve their management of development, and strengthen efforts related to law enforcement, clean government and democracy, as well as accountability. On the other hand, advanced countries gave their commitment to increase development aid to developing countries. In this regard, synergy is needed between development aid and greater access to world trade for countries receiving aid. The US plans to set aside a budget of

$5.0 billion for the next 3 years. The European Union has budgeted around $8.0 - $10.0 billion per year for a period of 3 years.

As regards the foreign debt problems of the developing countries, agreement had been reached to increase settlement efforts through the implementation of burden- sharing principles between lenders and borrowers, both between governments and between governments and the private sector. Foreign debt settlement mechanisms currently include debt swaps and debt relief schemes. Also, a review is being undertaken on the possibility of using special drawing rights in order to assist the financing needs of developing countries. An agreement had also been reached to increase policy coordination and coherence between international institutions that handle monetary, financial, trade, and developmental issues. In this relation, emphasis is given to the importance of increasing developing countries' participation in the decision-making process in various international institutions, specifically the IMF and World Bank.

Based on the "Monterrey Consensus", the World Bank made efforts to strengthen cooperation between the government sector, the private sector, and NGOs, as well as to harmonize various steps in order to promote the effectiveness of aid given by the World Bank and its umbrella institutions. Special attention is given to the promotion of growth in low-income countries and to those countries' capability in utilizing aid provided by the World Bank, through capacity building and improvements in corporate and public governance. During the meeting, world leaders pushed the World Bank to increase its aid to poor countries in order to increase the infrastructure needed for the utilization of opportunities arising from global trade.

In line with the Monterrey Consensus, during the IMF annual meetings in Washington in September 2002, a constituent Southeast Asian Group in the IMF stressed the importance of industrial countries opening their markets to developing countries. Economic infrastructure development with aid money will have fewer benefits if the industrial countries do not open channels for developing countries' exports and economic growth.

In line with the implementation of the Monterrey Consensus, the meeting of the G-20 central bank governors and finance ministers in New Delhi, India, in November 2002, stressed that the quality of aid is as important as the amount of aid. Allocation of aid money is often not optimal due to ineffective design and implementation strategies of aid programs. This is caused, among others, by the number of special interests (that is, the application of ad-hoc conditionality) represented by the financial aid, several of which are often for non-economic reasons. Therefore, in order to get effective benefit from aid, countries receiving aid should be given more flexibility and policy autonomy. In this regard, unconditional aid and a healthy combination of investment and program aid with a sectoral focus seem to be a good choice for developing countries.

In the case of Indonesia, the Monterrey Consensus should be a point of reference in formulating and implementing more integrated and sustainable national development policies. This is particularly the case as regards good governance in the public sector, law enforcement, institutional strengthening, and foreign aid effectiveness, in order to recover the confidence of international investors and aid donors. However, a clear commitment and hard work are needed on the part of the Indonesian government in realizing the above, mainly through increased domestic coordination, namely between the central government and regional governments; between governmental institutions/departments; and between the government and the House of Representatives.

HIPC, PRSP, and PRGF Programs

Efforts already undertaken by the IMF in cooperation with the World Bank to assist poor countries cover: (i) the Highly Indebted Poor Countries (HIPC) Program; (ii) Poverty Reduction Strategy Papers (PRSP); and (iii) the Poverty Reduction and Growth Facility (PRGF).

As regards the HIPC program, during the reporting year, progress on the initiative to settle poor countries' debts was quite encouraging. During the IMF/WB meeting in September 2002, it was mentioned that two-thirds of total poor countries had received benefits from the HIPC program. Problems had been particularly addressed for poor countries whose debts were considered no longer sustainable. In relation to this, there is a need to undertake a review of debt sustainability, as a basis for evaluation by governments and donor institutions in extending concessionary loans. An important issue that needs more attention is how to assist poor countries over longer-term periods after having successfully implemented the HIPC program. Many of these countries are heavily dependent upon certain commodities whose prices are volatile in international markets. Extended price declines could cause these countries to return to heavy borrowing. Developing countries re-emphasized the need for wider market access from advanced countries.

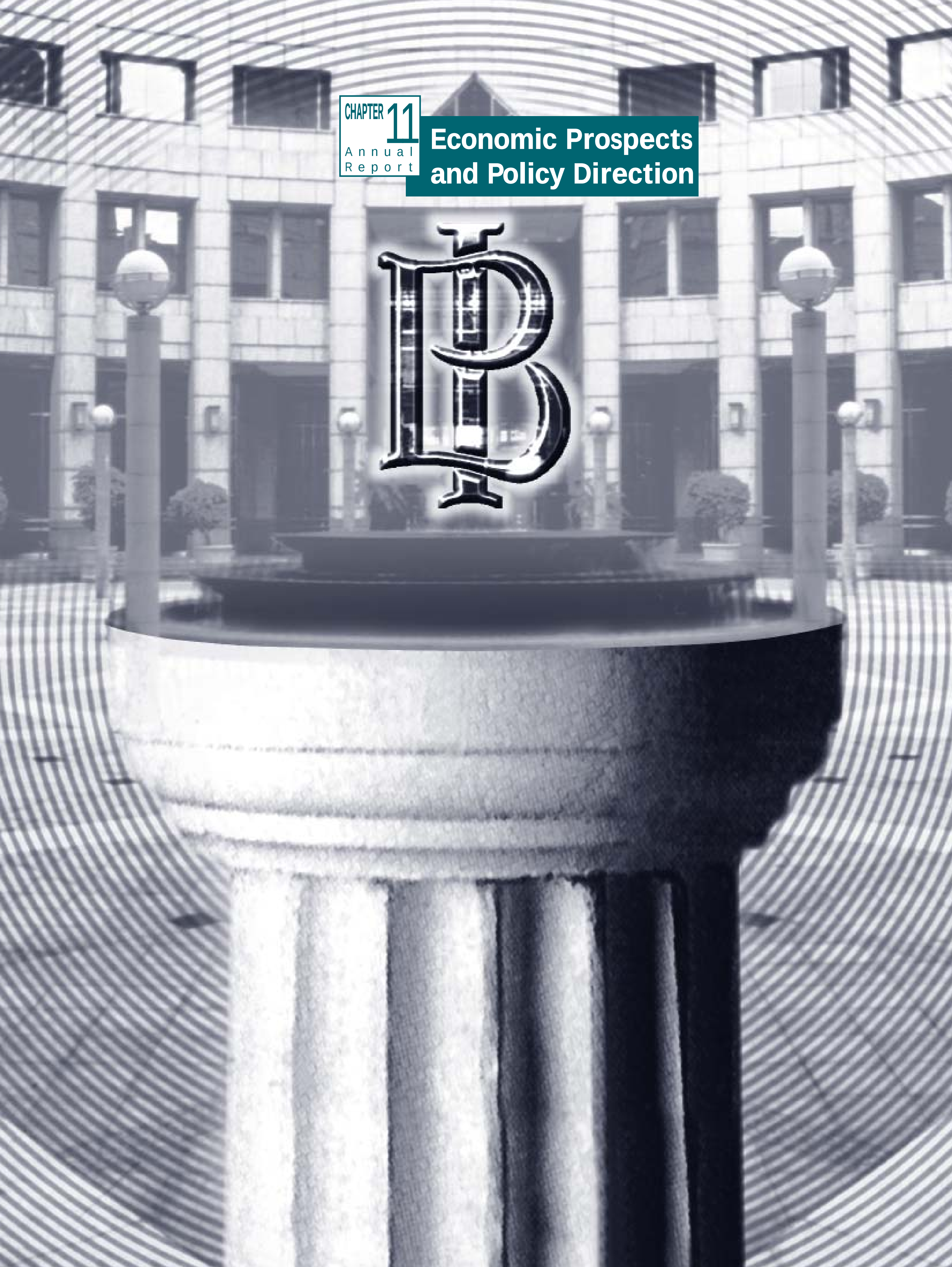
As regards the PRSP program, it has been successful in increasing development in poor countries, particularly post-conflict countries. In order for such aid to be more effective, those countries need to increase institutional capabilities, including coordination.

As regards the PRGF program, it has been one of the sources of growth in poor countries. Poor countries need to address various domestic problems, such as structural adjustments and healthy macro policies. In addition, poor countries need market access, especially for their agricultural products. The IMF and World Bank need to devise country-owned program designs in order to promote economic growth and reduce poverty. The PRGF also needs to be more flexible in order to fit specific country conditions.

In addition to the above-mentioned programs, in its annual report the World Bank stressed efforts to increase education in order to alleviate poverty and inequality as a basis for strong economic growth. The World Bank in cooperation with the Dutch government made efforts to increase educational opportunities through the "Education for The World's Children" program. In this regard, steps have been developed in order to achieve an international consensus concerning the availability of basic education to all children by 2015. To realize this objective, the World Bank also works together with the United Nations' specialized agencies, such as UNESCO.

CHAPTER 11
Annual Report

Economic Prospects and Policy Direction



CHAPTER 11

ECONOMIC PROSPECTS AND POLICY DIRECTIONS

Economic growth in 2003 is forecast to reach 3.5% - 4.0% due to improving performance of investment and exports. With prospect of declining inflation and relatively liquid banking conditions, monetary policy will be directed to gradually lower interest rates so as to strengthen positive signals concerning the economic recovery.

Economic growth is forecast to increase in 2003, despite dependence upon successful handling of various risks and structural problems, originating externally and domestically. On the external side, relatively slow growth in several developed countries and rising political tensions in the Middle East could further weaken the global investment climate. Also, financial scandals among international corporations have reduced investors' desire to invest, including in developing countries. On the domestic side, various fundamental economic problems (such as, incomplete recovery of bank intermediation and a fiscal deficit) and socio-political issues (such as, a rising labor conflicts, poor public perceptions on the supremacy of law and concerns about security conditions before the 2004 General Election) must be carefully monitored.

If the impact of these various risks and uncertainties can be minimized, economic growth in 2003 is forecast to reach 3.5%-4.0%. From the demand side, the main source of growth is still likely to be consumption. Despite global conditions that are not fully supportive, growth in exports and investment is set to improve, but not significantly. From the supply side, all economic sectors are forecast to expand. High growth is expected to occur in electricity, gas and clean water, transportation and telecommunications, and construction. However, the impact of the Bali tragedy is predicted to linger in several sectors, mainly those related to tourism and hotels. Deterioration in these sectors would also affect the performance of Indonesia's Balance of Payments.

Overall, Indonesia's Balance of Payments (BOP) in 2003 is forecast to weaken slightly compared to the previous year. This is mainly due to a declining surplus on current account as a result of a widening deficit on services and a narrowing surplus on goods transactions. The capital account is forecast to deteriorate slightly, mainly due to a widening deficit on the private capital account.

The rupiah exchange rate is forecast to strengthen in 2003. This forecast is in line with market surveys indicating that the rupiah will tend to appreciate and exhibit relative stability. Although market sentiment still needs close watch, exchange rate stability will be supported by improved fundamentals. In particular, there would be an adequate supply of foreign currency originating in export receipts;

inflows of foreign loans; IBRA asset sales; privatization of state-owned enterprises; divestment of recap banks; and portfolio inflows.

In line with moderate economic growth and a mildly appreciating and stable exchange rate, CPI inflation in 2003 is forecast to decline from the previous year. Lower inflation will also stem from the reduced impact of government policy concerning prices and incomes, and from lower public inflationary expectations.

Also in line with improved macroeconomic conditions, Indonesia's banking system will strengthen in 2003 with an increase in mobilized funds, expansion of credit, a decline in NPL ratio; and improved CAR.

GLOBAL ECONOMIC PROSPECTS

World Economic Growth and Trade

World economic growth is forecast to increase slightly in 2003. Based on the latest IMF forecast[1] the world economy will expand by 3.7%, up from 2.8% in 2002. However, this increase is largely contributed by high growth developing countries, particularly in China and the ASEAN region. Economic growth in Indonesia's main trading partners (the United States, Japan and the European Union) would be considerably lower. In addition, growth is susceptible to certain key uncertainties, such as rising geopolitical risk and exceptional dependence of the world economy upon recovery in the US economy.

Although world economic prospects are generally forecast to improve, economic growth in several developed countries is expected to be relatively weak. Economic growth in the US, Japan and the Euro Zone are forecast at 2.6%, 1.1%, and 2.3%, respectively. The forecast for slower US economic growth in 2003 is mainly due to slower consumption growth resulting from the drop in stock prices and high level of unemployment, mainly due to moderate expansion of consumption, resulting from the drop in stock prices and high levels of unemployment. The growth in the Euro Zone stems from a recovery in consumption, a rise in incomes and low inflation. In addition, investment is expected to pick up in line with rising stock prices, corporate earnings and utilization rates of production capacity. The Japanese economy is forecast to be volatile and to remain highly dependent on exports; growth could fade, if the yen appreciates enough to restrain exports.

Growth in developing countries is forecast to exceed that of developed countries. In 2003, the growth in the developing countries of Africa, Asia, ASEAN-4 and Latin America will tend to rise, to 4.2%, 6.3%, 4.2%

(Percent)

Table 11.1
Economic Growth in Several Regions of the World

Item	2001	2002*	2003*
World Economic Growth	2.2	2.8	3.7
Industrial Countries	0.8	1.7	2.5
United States of America	0.3	2.2	2.6
Japan	-0.3	-0.5	1.1
European Union	1.6	1.1	2.3
Asian Newly Industrialized Countries	0.8	4.7	4.9
Developing Countries	3.9	4.2	5.2
Africa	3.5	3.1	4.2
Asia	5.6	6.1	6.3
China	5.6	7.5	7.2
ASEAN-4 **	2.6	3.6	4.2
Latin America	0.6	-0.6	3.0
Countries in Transition	5.0	3.9	4.5

Sources : IMF, World Economic Outlook, September 2002
* Projection
** Consist of Indonesia, Malaysia, Phillippines, and Thailand

1 World Economic Outlook, September 2002.

and 3.0%, respectively. This improvement mainly stems from domestic demand (which is generally large in these economies), supported by easy bias macroeconomic policies, especially in countries with controlled inflation rates.

International Inflation and Interest Rates

In line with stronger aggregate demand, world inflation in 2003 is forecast to be slightly higher mainly in developing countries. Inflation in developed countries (such as the US, Japan and the European Union) is expected to rise only a little, due to relatively weak demand. In addition, inflows of relatively cheap imported goods will help hold down prices (Table 11.2). With relatively low growth and restrained inflation, interest rates are expected to remain low in 2003 adding a stimulus to growth.

Prospects for Commodity Prices in the International Market

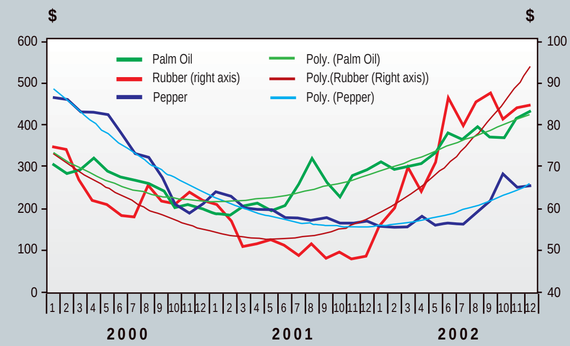
In general, international commodity prices are forecast to rise slightly because of higher non-oil/gas prices. However, oil prices may slightly decline from

(Percent)

Table 11.2
Development of International Inflation and Interest Rates

Item	2001	2002*	2003*
Inflation			
Industrial Countries	2.2	1.4	1.7
Developing Countries	5.7	5.6	6
Countries in Transition	15.9	11.3	8.8
Short-term Interest Rate			
United States of America	3.7	2.1	3.2
Japan	0.2	0.1	0.1
European Union	4.1	3.4	3.8

Sources : IMF, World Economic Outlook, September 2002
* Projection



Graph 11.1
Development of Agricultural Commodity Prices

their relatively high levels at the end of 2002. Higher crude oil production and larger stocks in developed countries will more than offset the impact of political tensions in the Middle East and the deteriorating situation in Venezuela.

The rising trend in international non-oil/gas prices during 2002 is forecast to continue in 2003, in line with the stronger world economy. The main contributors to the trend will be agricultural commodities and manufacturing raw materials, including palm oil, cocoa and timber. The prices of coffee and sugar are forecast to be low, while minerals and metals prices are forecast to be stable because world stocks are adequate and production is still relatively weak.

Oil prices, which rose during the second half of 2002, will probably return towards the OPEC price range ($22-$28 per barrel) in 2003. Factors inducing the drop in oil prices include less negative market sentiment regarding a US attack on Iraq; stable world oil stocks; and plans to raise the production quota of OPEC countries (Table 11.3).

(Million Barrel Per Day)

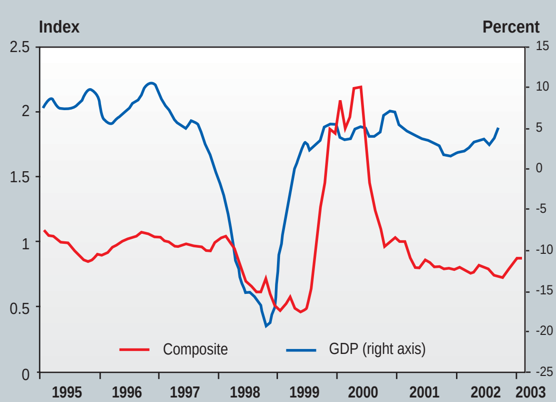
Table 11.3
Forecast of World Oil Demand Production

I t e m	2002				2003			
	I	II	III	IV	I	II	III	IV
Demand	76.6	74.8	76.2	77.5	78.2	76.1	77.3	79.1
OECD	47.9	46.2	47.8	48.8	49.1	46.8	48.4	49.8
United State of America	19.4	19.6	19.9	20.0	20.3	20.1	20.5	20.8
Others	28.5	26.6	27.9	28.8	28.8	26.7	27.9	29.0
Non OECD	11.7	12.0	12.0	11.9	11.8	12.1	12.2	12.1
Total Production	75.3	75.0	75.6	77.9	77.6	77.4	78.2	78.7
OECD	23.6	23.6	23.1	24.0	24.0	23.6	23.9	24.2
Non OECD	51.7	51.4	52.5	53.9	53.6	53.8	54.3	54.5
OPEC	27.9	27.4	28.2	29.3	29.2	29.1	29.1	29.1
Others	23.8	24.0	24.3	24.6	24.4	24.7	25.2	25.4
Changes in Stock	-1.3	0.2	-0.6	0.4	-0.6	1.3	0.9	-0.4

Source : Energy Information Agency, Short Term Energy Outlook, November 2002

PROSPECTS FOR THE INDONESIAN ECONOMY

Overall, the Indonesian economy is expected to grow by around 3.5%-4.0% in 2003, slightly higher than in 2002. This forecast has been scaled back following the Bali tragedy. On the demand side, the main source of growth is still consumption. Although still limited, the contribution of exports to economic growth will pick up somewhat, in line with international economic improvements. On the supply side, all economic sectors will expand with the largest share still coming from manufacturing. This forecast of moderate overall growth is in line with a relatively flat tendency in the Index of Leading Economic Indicators[2] (Graph 11.2).



Graph 11.2
Economic Leading Indicators

The consensus forecast among economic and financial institutions (December 2002) was for Indonesian economic growth in 2003 in the **range of 2.9%-4.2% with an average of 3.6%.** The Bali tragedy caused several economic institutions to revise their forecasts downward by 0.7%-1.0% due to higher risk premiums and declines in investor and consumer confidence.

Demand Prospects

From the demand side, the main force for economic growth is still private consumption. This reflects government policy to raise salaries and

2 This Index is a composite of several economic indicators such as the CPI, real M2, Clearing Transaction Volumes, the Stock Price Composite Index and the Business Survey.

(Percent)

Table 11.4 Forecast of GDP Growth by Expenditure		
Expenditure Components	**2002***	**2003****
Private Consumption	4.7	4.3 - 4.8
Goverment Consumption	12.8	12.8 - 13.3
Total Consumption	5.5	5.2 - 5.7
Total Investment	-0.2	0.8 - 1.3
Goods and Services Export	-1.2	1.0 - 1.5
Goods and Services Import	-8.3	1.7 - 2.2
Gross Domestic Product	3.7	3.5 - 4.0

* Bank Indonesia Forecast
** Bank Indonesia Projection

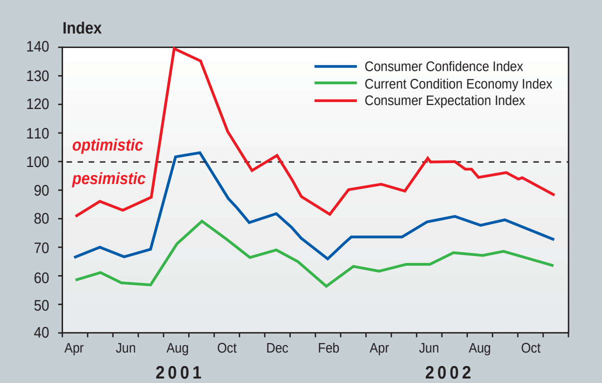
minimum provincial wages (UMP) in conjunction with relatively stable price movement. Exports and investment may also expand, but their contributions to growth will be quite limited. Low growth in exports and investment are due to certain structural problems and low international confidence in the Indonesian economy.

In 2003, private consumption is expected to grow by some 4.3%-4.8%, which is down from 2002 (Graph 11.3). This slower growth reflects declining public purchasing power resulting from higher unemployment, declines in income transfers from TKI (Indonesian workers abroad) and reduced government subsidies.

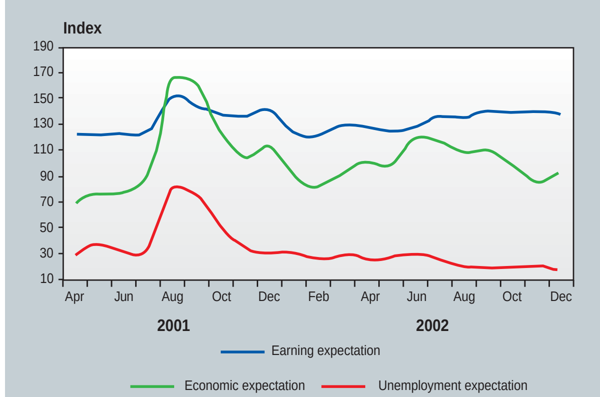
The slower growth in private consumption is also indicated by developments on the financing side. The slowdown in consumer credit and finance during 2002 is expected to continue in 2003. In addition, card-based payment systems indicate declining transaction values per cardholder.

Weak consumption is also suggested by the consumer expectations index, which is still within the pessimistic range (Graph 11.4). Consumers' pessimism 6-12 months ahead is mainly driven by the prospect of higher unemployment; the expectations index regarding economic prospects improved in December 2002, but it still indicates a pessimistic outlook. In addition, consumers remain reluctant to purchase durable goods in the coming 6-12 months. The only element of optimism in respondents' consumption plans concerned the category of clothing and recreation/traveling (Graph 11.5).

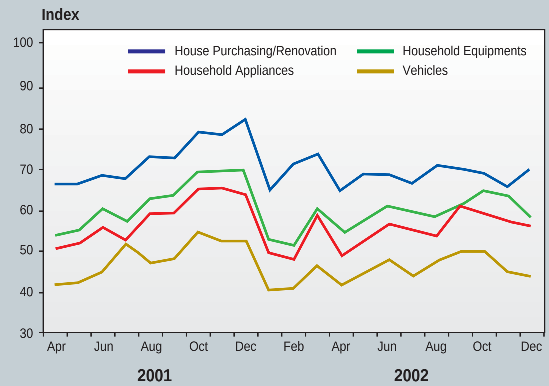
Government consumption is expected to grow by around 12.8%-13.3%. This is up from 2002 due to higher routine government spending, especially for salaries, goods, regional budget expenditures (especially for balanced budget). Higher regional budget



Graph 11.3
Consumer Survey Index



Graph 11.4
Components of Consumer Expectation Index



Graph 11.5
Consumption Plan within next 6 - 12 Months

expenditures will boost consumption in the regions, which improves the distribution of income.

Investment spending will grow by around 0.8%-1.3% in 2003. The growth is largely stems from various central government and state owned enterprise projects. Private investment is forecast to remain limited.

The government projects contributing to investment are mostly resumptions of delayed projects, such as toll roads, electricity, telecommunications and petrochemicals. The financing comes from two sources, foreign loan disbursements and bond issuance by several state owned enterprises.

The outlook for private investment is still rather gloomy. Despite progress in debt restructuring by several corporate groups and improved banking conditions, the available financing is still quite limited. Private investors with sizable investment plans are, by and large, companies that have been operating for an extended period in Indonesia.

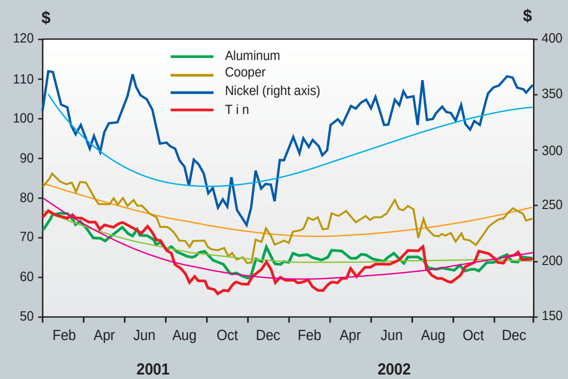
International investors' perceptions of the Indonesian investment climate need to be monitored cautiously because some rating agencies still assess the domestic investment climate as high risk.External factors have also caused investors to avoid investment in high-risk assets, for instance, global security risks and low economic growth in developed countries. One aspect of this has been the declining share of US and European investments in Asia, despite relatively high growth in much of the region. Further in this regard, the declining trend in world Foreign Direct Investment (down 27% in dollar in 2002) is forecast to continue next year.

In these circumstances, efforts to mobilize more investment seem to need a sharper policy focus, including priorities for developing domestic industry. Under the worst scenario, business relocation abroad is likely to reoccur since they do not rely much on domestic raw materials.

As for exports, they are expected to expand by 1.0%-1.5% in line with improved growth prospects in various trading partners of Indonesia. Various government policies will also be helpful in this regard. For example, initiatives that seek new market breakthroughs in areas like the Middle East and Latin America; the application of counter purchase schemes; and efforts to recover international confidence through road shows and trade exhibitions.

The demand for several major export commodities is forecast to improve in 2003, including tin, aluminum, and nickel (Graph 11.6). This forecast is in line with the research of several independent institutions that anticipate rising demand for mining products.

Higher exports are also supported further by rising prices for several plantation crops, such as palm oil, cocoa, rubber and other agribusiness



Graph 11.6
Development of Mineral Commodity Price

products. Higher prices are expected to encourage producers to expand output, which will increase employment.

There are still potential problems that could restrict exports and these need to be monitored carefully. By way of examples in this regard, rising costs of production, security problems, and mushrooming labor disputes have caused several foreign buyers to shift their orders to countries that are more competitive and able to guarantee continuity of supply.

Imports are forecast to grow by around 1.9%-2.2% in 2003, slightly more than in the previous year, reflecting movements in exports, consumption and investment. In addition, the implementation of AFTA in early 2003 is expected to reduce import tariffs on several goods (e.g., plastics and chemical products), which should encourage imports. However, other policies that will restrain imports should be noted. These concern measures aimed at protecting domestic industries, such as textiles (constraints imposed on producers and raw materials), sugar, and hot and cold rolled steel.

Supply Prospects

All economic sectors are forecast to expand in 2003. The highest growth will be in electricity, gas and clean water; transportation and telecommunications; and construction. Manufacturing, which has a large share to GDP, is expected to rise appreciably compared with the previous year. This outlook is supported by the government commitment to speed up the economic recovery by re-starting several large infrastructure projects. Development of these infrastructure projects is anticipated to have a large multiplier effect on other sectors, raising employment and boosting overall economic growth.

Agriculture sector (including agriculture, animal husbandry, estate crops, fisheries, and forestry) is forecast to decelerate in 2003 (Table 11.5). The lower growth is due to the lagged effects of the long drought at the end of 2002, aggravated by the flooding of several production centers early in this rainy season. Nonetheless, positive growth can be maintained through efforts such as, intensification and extensification programs; the set up of floor price of unhusked paddy grain; higher tariffs on rice imports; and fertilizer subsidies.

(Percent)

Table 11.5
Forecast of GDP Growth by Sector 2002 – 2003 (y-o-y)

Sector	2002	2003
Agriculture	1.7	1.1 - 1.6
Mining	2.3	2.3 - 2.8
Manufacturing	4.0	4.4 - 4.9
Electricity	6.2	7.0 - 7.5
Construction	4.1	5.4 - 5.9
Trade	3.6	3.0 - 3.5
Transportation	7.8	7.8 - 8.3
Finance	5.6	5.8 - 6.3
Services	2.0	0.9 - 1.4
Total	3.6	3.5 - 4.0

The food crops intensification program is conducted by using dry land and tidal lowlands; enhancing the quality of irrigation (mainly outside Java); increasing productivity; self sufficiency, and better crop marketing. The extensification program covers the expansion of arable land and land conversion (mainly in-Java). These programs are implemented through the Agribusiness Society of Estate Crops Action Program (Program Aksi Masyarakat Agribisnis Tanaman Pangen/Proksi Mantap) conducted in 200 districts/ cities. In the meantime, the government has provided direct subsidies of fertilizer such that the price is affordable for farmers. To maintain the supply of fertilizer, the government and fertilizer distributors will monitor the fertilizer distribution system.

However, other factors could limit crop production in 2003. For example, lower water supply to a number of dams and riverbanks due to the drought during the planting season (October –December 2002) could reduce the harvest yield in March-May 2003. Also, the stock of seeds of rice, corn and soy beans for the planting season of 2002-2003 is suspected to be in shortage; as of October 2002, the stock of seeds had reached just 15% of needs.

The mining and quarrying sector is expected to grow higher than last year, but the growth will still be lower than during the pre-crisis period. Lack of security and legal certainty remain the main problems in this sector. Other constraints include unclear mining contracts, overlapping land claims and regional autonomy (mainly in the areas of taxation, user charges and other local charges). For instance, mining exploration in conserved forestry areas seems to be hindered by Law No.41/1999.

However, investment in mining continues, such as coal mining in Parambahan, Sawahlunto-West Sumatra by Camco International from China and oil exploration by Pertamina in cooperation with Malaysia, Iraq, and Vietnam. In addition, there are 22 mining projects in the eastern region of Indonesia and several new oil and gas finds in Cepu, Deep Sea of Makassar, and in a number of other remote areas in Indonesia. Also beginning in 2003, Pertamina will supply LNG in the amount of 2.6 million tons per year to the Jiangshu province of China under a 20-year contract, using the Badak Bontang pipeline. (This follows the Tangguh field exports to Fujian-China in 2002.) Coal production is projected to rise slightly from 9.6 million tons in 2002 to 9.8 million tons in 2003.

Manufacturing sector remains the engine of economic growth. This sector is forecast to accelerate from 2002, mainly to meet domestic demand boosted by various policy packages to improve the business climate. To speed up the development of manufacturing and trade, starting in 2003 the government will revitalize the manufacturing sector in order to help capacity utilization to rebound to pre-crisis levels. The revitalization program will cover four branches, namely textiles and textile products, electronics, footwear, and processed timber and pulp.

Output of the steel industry will rise in line with the construction of buildings, toll roads, and other infrastructure, and the government policy to raise the tariff of hot rolled coil (HRC) and cold rolled coil (CRC) by 20.0% and 25.0% from the previous levels of 5.0%-15.0%. Also cement output will rise reflecting domestic consumption growth of 8.0%-10.0%. To anticipate higher demand, several cement producers expanded factory capacity, mainly outside Java.

Several other industries are forecast to expand their capacity in response to the resumption of several mega projects. The petrochemical industry will also add capacity by revamping to its ammonia units. Food and beverages will grow in parallel with rising domestic demand. Of particular note is domestic consumption of packaged drinking water (aqua), which is projected to grow by 20.0% per year up to 2005. The automotive industry is forecast to expand in line with higher demand for cars, by around 10.0%-12.0% compared with 2002 and sales of motor vehicles of around 15.0%. Likewise, production of motor vehicle tires is set to rise by 10.0%-25.0%. Moreover, a production center is going to be built in Eastern Indonesia one of which will specialize in oleum and cocoa butter.

By contrast, output of **electronics and footwear sector is** forecast to decline following companies' plans to close plants and relocate production abroad. The closing of these plants is due to reduced orders, higher operational costs, and labor and security problems, all of which have eroded profit margins. The textile and textile product industry is forecast to face problems of competitiveness since equipment is generally outdated and imports are becoming cheaper.

The electricity, gas and clean water sector is expected to grow rapidly due to demand for electricity that usually increases by about 9.0% per annum. Higher demand will be met by optimizing the existing electricity power generation and by building new power plants in cooperation with Independent Power Producers/IPP. Projects that are going to add electric supply (or transmission) capacity in 2003 include:

a. Tanjung Jati B in Jepara PLTP Dieng (Unit 4) at Central Java
b. Paiton: PLTP Cibuni at West Java
c. Tanjung Jati A : PLTP Sarulla
d. PLTU Serang : PLTGU East Palembang at South Sumatra
e. PLTP Bedugul (Units 1,2,3,4): High Voltage Transmission at Klaten (Central Java)
f. PLTP Patuha (Units 1,2,3,4): High Voltage Transmission at North Sulawesi
g. PLTP Kamojang : High Voltage Transmission at South Sulawesi
h. PLTP Sibayak : PLTD (Diesel) at West Nusa Tenggara

Construction sector is also forecast to accelerate in 2003, mainly due to new toll roads which are expected to have a large impact on business, labor absorption, inflows of foreign investment and overall economic growth. In addition, several local governments plan to build more infrastructure, such as main roads, bus terminals, and bridges. The development of infrastructure also includes double-tracking railways in several locations on-Java.

In other types of construction, the government is forecast to increase the output of simple/very simple types of housing to 180 thousands units in 2003 and the development of irrigation is going to increase by 10.0%. Development of real estate (including shopping centers) by private developers is forecast to rise by 10.0%.

The trade, hotels and restaurants sector is expected to decelerate in 2003. The retail trade sub-sector will slow to around 3.0%, reflecting the slowdown in consumption growth. The effect will be particularly noticeable in Bali, where retail trade (mainly in handicrafts and souvenirs) is forecast to decline due to lower numbers of visitors.

The hotel sub-sector would also decline since visitors to Indonesia are forecast to drop by 25.0% or around 1 million people (foreign and domestic visitors) due to the Bali tragedy. To recover the image of tourism in Bali, the government in cooperation with the private sector is undertaking a recovery program with 4 steps, namely: rescue; rehabilitation; normalization; and expansion. The restaurant sub-sector will expand due to the opening of several internationally famous chain restaurants.

Transportation and telecommunications sector is forecast to grow at a faster pace in 2003 than in 2002. The impact of the Bali tragedy on transportation (particularly air transportation) is not expected to be long lasting. Railway transportation will rise in line with government plans to purchase a number of railway cars from Germany and to double-track some railway lines on-Java.

The telecommunication sub-sector is expected to grow rapidly in line with the plans of PT. Telkom to build a new 6-part telephone network; the Code Division Multi Access (CDMA); two supporting packages; and two packages of a Public Switch Telephone Network (PSTN). To meet demand for current bandwidth, in 2003 PT Telkom in cooperation with two foreign companies is going to build an under-ocean cable network. PT Telkom is also going to build a cellular telephone system through its branch companies.

Banking and Other Financial Institutions sectors will strengthen in 2003 in line with the re-building of public confidence in the national banking system. Several bank indicators are forecast to expand, such as funds mobilized, credit, capital and profitability. This improvement is also in line with the assessment of S&P rating agency as reflected in its upgrading of the outlook for banking from "negative" to "stable". Despite this upgrade, the banking services sector is still subject to high economic and sectoral risks.

In line with rising consumption, consumer finance from banks is forecast to continue increasing in 2003, especially for housing and motor vehicle financing. Credit from pawnshops (whose funds originated in bond issuance) is also rising.

Services sector is forecast to grow at a slower pace in 2003 due to the impact of the Bali Tragedy (especially to private services sector). In several tourist destination (mainly in Bali), amusement and recreation services and personal and household services (such as tourist guide) are forecast to decrease.

The Balance of Payments Prospects

In 2003, the performance of Indonesia's Balance of Payments is forecast to deteriorate, as reflected in a narrowing of the overall surplus from $3.6 billion to $1.0 billion (Table 11.6).

The current account will record a surplus of $4.7 billion, less than the previous year's surplus of $7.3 billion. This decline partly originates in a rising deficit on the services account, while the surplus on goods transactions will narrow from last year. The growth in exports and imports in 2003 is forecast to reach 1.3% and 2.8%, respectively. Forecast for exports growth is higher than in the previous year (1.1%)

Export growth is mainly accounted for by non-

(Billions of $)

Table 11.6
Indonesia's Balance of Payments Projection

Item	2002*	2003*
A. Current Account	**7.3**	**4.7**
1. Trade Account	**23.1**	**22.9**
a. Exports (fob)	58.0	58.7
Non-oil and gas	45.3	46.6
Oil and gas	12.7	12.1
Oil	6.7	6.1
LNG	5.7	5.6
LPG	0.3	0.3
b. Imports (fob)	-34.8	-35.8
Non-oil and gas	-28.3	-29.7
Oil and gas	-6.6	-6.1
Oil	-6.3	-5.8
Gas	-0.3	-0.3
2. Services Accounts	**-15.9**	**-18.2**
a. Non-oil and gas	-11.6	-13.8
b. Oil and gas	-4.2	-4.4
Oil	-2.1	-2.2
Gas	-2.1	-2.2
B. Capital Account	**-3.6**	**-3.7**
1. Net Official Capital	**-0.6**	**1.8**
a. Official Inflows	1.3	3.8
b. Debt Repayment[1)]	-1.8	-1.9
2. Net Private Capital	**-3.0**	**-5.6**
a. Net Direct Investment	-6.9	-1.3
b. Others (net)	3.9	-4.2
C. Total (A+B)	**3.7**	**1.0**
D. Net Errors and Omission	**-0.1**	**0.0**
E. Monetary Movements[2)]	**-3.6**	**-1.0**
Notes :		
1. Gross Foreign Assets (GFA)[3)]	31.6	32.6
Equivalent to non-oil and gas imports and official foreign debt repayments (months)	6.6	6.7
2. Current Account/GDP (%)	3.9	2.2

1) Taking into account the rescheduling
2) Minus (-) : Suplus, and vice versa
3) Since 2000, based on IRFCL concept, replacing GFA concept

oil/gas exports that are set to expand by 3.0%, in line with improving world economic developments in 2003. This growth will occur in all sectors, that is, agriculture, mining and manufacturing. The highest growth is in agriculture and mining (both 3.4%); exports of manufactures will increase by 2.9%.

For their part, oil/gas exports are forecast to decrease compared with the previous year. Oil prices, which rose during 2002, will not continue in 2003, such that the oil export revenues will be smaller than the receipts of previous year.

Imports are expected to grow by 2.8% in 2003, compared with 0.5% in 2002. This is in line with higher overall growth in 2003. By category of goods, the growth of consumption goods imports remains the largest, followed by raw materials and capital goods.

Unfavorable developments are predicted to take place in the services account, which will be in a deficit of $18.2 billion, substantially wider than a year previously. The wider deficit partly originates in a drop in receipts from tourism due to falling numbers of foreign visitors to Indonesia after the Bali tragedy. In 2003, foreign arrivals would fall to 4.1 million people versus 4.7 million last year. The estimated drop in foreign exchange receipts is around $0.6 billion.

On the capital account, the deficit will widen slightly from $3.6 billion to $3.7 billion. This stems from a wider deficit on the private capital account; the official capital account swings into surplus following a deficit in 2002. The private capital account deficit in 2003 is forecast at $5.6 billion compared with $3.0 billion last year. The official account surplus would be $1.8 billion, versus a deficit of $0.6 billion in 2002. This surplus on official account is mainly due to a drop in net IMF repurchases and an increase in withdrawal of foreign (program and project) loans.

Against this background, official foreign exchange reserves at the end of 2003 are forecast to reach $32.6 billion. This is equivalent to 6.7 months of imports and official foreign debt repayments.

Exchange Rate Prospects

In 2003, the average rupiah exchange rate is expected to appreciate compared with 2002. Using the model approach of "Behavioral Equilibrium Exchange Rate" (BEER) the rupiah is forecast to fluctuate within the range of Rp8,800-Rp9,200 per dollar. This forecast has taken into account the impact of the Bali tragedy; domestic and foreign sentiment; supply-demand imbalances of foreign exchange in the domestic market; surveys;[3] and Bank Indonesia's commitment to maintain rupiah exchange rate stability through exchange rate intervention. Based upon estimates of Indonesia's Bilateral Real Effective Exchange Rate (BRER), the exchange rate would remain quite competitive in pushing Indonesia's exports.

By factors affecting the exchange rate, this appreciation would be supported in part by quite conducive fundamentals and some positive market sentiment. Several factors that could trigger negative sentiment are expected to have their impact dampened by various policies of Bank Indonesia and the Government.

On the side of fundamentals, the rupiah will be supported by relatively balanced supply conditions in the domestic foreign exchange market. Genuine supply of foreign exchange will originate in foreign exchange receipts from exports and inflows of foreign capital. These inflows of foreign capital would take the form of foreign loans and investments; asset purchases by foreigners, including of IBRA assets; commercial paper and foreign bonds issued by domestic corporations; the continuing privatization of State Owned Enterprises program; and the divestment of recap banks. On the demand side of this market, genuine demand for foreign exchange can come from the private sector and various government institutions, including State Owned Enterprises, mainly for imports and servicing foreign debts. Pressure from the side of debt servicing will be further reduced in 2003 due to foreign debt restructuring (by the government and the private sector) through the Paris and London Clubs and the Jakarta Initiative Task Force (JITF).

Concerning sentiment, various positive and negative factors are likely to color the market in 2003. Positive market sentiment is expected to continue following the government's successful handling of the Bali tragedy. This is expected to help the recovery of international confidence in Indonesia; foreign exchange revenues from tourism and portfolio investment will rebound after a temporary drop in the wake of the bombings. Other positive factors include: a possible strengthening of regional exchange rates due to a widening US trade deficit; multiplier effects from the implementation of 14 government mega projects; and the privatization and divestment programs.

However, there are several **sources of negative sentiment** that could also emerge in 2003. These will increase risk and uncertainty, and they have the potential to trigger foreign exchange speculation. These factors include legal uncertainty and domestic security conditions; a higher cost local economy resulting from the implementation of regional autonomy; new labor

3 In a survey conducted by Bank Indonesia in December 2002, most respondents forecast that the average rupiah exchange rate would strengthen in 2003, despite a tendency to depreciate towards the end of first semester 2003 wit the approach of the Annual MPR meeting. The December 2002 survey indicated that it would average Rp9,000 per dollar compared with Rp9,052 per dollar in the November 2002 survey.

regulations that are not conducive to investment and job creation; not fully recovered bank disintermediation; and the huge fiscal burden. The foreign exchange market could also be affected by escalating political tensions in July-August 2003 before the Annual General Assembly Meeting and by preparations for the 2004 General Election. Moreover, global political tension is likely to be on the rise due to terrorism issues and the possibility of war in the Middle East.

Concerning policies, potential fluctuations in the exchange rate could be dampened (or even eliminated) by efforts to strengthen the micro structure of the foreign exchange market in Indonesia and by accelerating bank re-intermediation. Such policies will encourage banks to reduce their placements abroad and raise exporters' interest in repatriating their export revenues.[4] In the meantime, in order to minimize exchange rate fluctuations, Bank Indonesia remains committed to its intervention policy in the foreign exchange market.

Prospects for Inflation

Inflationary developments in Indonesia are affected by fundamental factors associated with macroeconomic conditions and by non-fundamental shocks. The fundamental factors are mainly aggregate demand and supply; external factors that have a pass through effect on prices; and the public's inflationary expectations. For their part, shocks mainly originate in the implementation of government prices and incomes policies, natural disasters, and problems with supply distribution. Taking into consideration all these factors, inflation in 2003 and in the medium-term is forecast to trend downwards.

Inflationary Prospects for 2003

Based on factors affecting inflation, inflationary pressures are likely to decline in 2003 from the side of both fundamental and non-fundamental factors. Regarding the former, demand conditions are not strong enough to exert inflationary pressure; inflationary expectations are declining; and the exchange rate is strengthening. Concerning non-fundamentals, government policy on prices and incomes is expected to make a significant contribution to inflation, but its impact will be lower than in 2002.

The interaction between demand and supply in 2003 is forecast to exert insignificant pressure on inflation. This is mainly due to various demand indicators that point towards low growth.

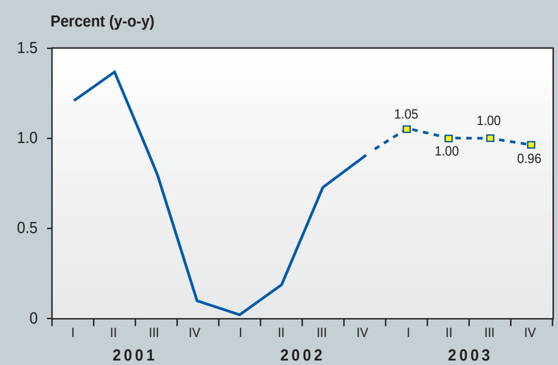
Demand pressure, which is only moderate, is due to private consumption growth; the increase in government consumption is not likely to have a significant impact because its share is quite small. Likewise, foreign demand is forecast to be relatively weak and will not exert any significant inflationary pressure.

From the supply side, low investment growth in the past two years has added little to economic capacity. This could make it difficult to meet rising demand in the future; potentially, inflationary pressure

4 Foreign exchange placements in the domestic foreign exchange money market (PUAB valas) are still considered high risk. This is due to the still fragile national banking system vis-a-vis systemic risks, as reflected in the limited loosening of credit lines of national banks to get access to the PUAB valas. Without improvements, market segmentation could increase which could render the domestic money market inefficient and illiquid. Also, foreign exchange credits—mainly investment credits—will remain limited if banks with surplus liquidity continue to have difficulty in finding businesses with good prospects.

could emerge due to limited aggregate supply some years ahead. By sector, inflationary pressure could result from a poor agricultural harvest that limits the local food supply. The distribution network (as represented by the wholesale and retail trade sectors) is not likely to be the source of inflationary pressure because of lower growth in that sector, mainly originating in retail trade and hotels.

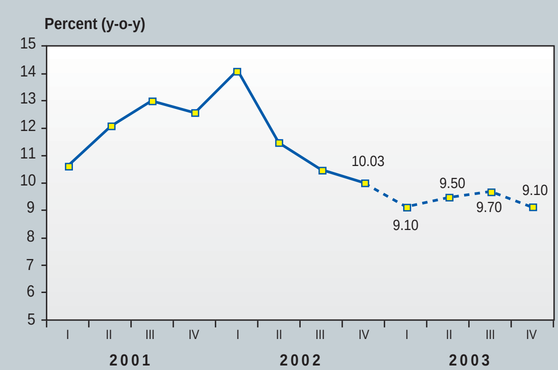
Inflationary pressures from the external sector in 2003 will be insignificant due to the appreciating rupiah and low inflation in the economies of trading partners. As mentioned, the exchange rate would strengthen on average in 2003 (to Rp9,000 per dollar) with an appreciation early in the year and a depreciation towards year end. In the meantime, world economic growth will pick up only slightly in 2003 and will not be a source of significant pressure on world inflation. By way of illustration, average inflation in several of Indonesia's major trading partners is forecast to rise from 0.90% to 0.96% (y-o-y). The trading partners who are the source of most imports of goods to Indonesia are Japan, US, Korea, Singapore, China, Thailand, Australia and Malaysia.



Graph 11.7
Development of Inflation Composit in Several Trading Partners

The public's expectations of inflation constitutes the dominant factor in the forecast of declining inflation in 2003. Inflationary expectations are largely determined by inflation in the previous period (adaptive expectations) and developments in economic conditions that have a close relationship with inflation (most notably monetary policy, the exchange rate and government policy on prices and incomes). For 2003, inflationary expectations are predicted to decline compared with 2002. This is reflected in the consensus forecast and traders' expectations on up-coming price developments which show a declining trend. The consensus forecast for inflation in 2003 is generally lower than in 2002, despite an up-tick around mid year (Graph 11.8). Similarly, the Retail Sales Survey indicates a declining number of respondents who anticipate price increases 6 months ahead. This could indicate declining inflationary expectations during that period (Graph 11.9).

Government policies on prices and incomes in 2003 are forecast, to make a significant contribution to CPI inflation, of about 3.02%. This is mainly due to several plans to raise tariffs, incomes and some



Graph 11.8
Inflation Expectation Based on Concensus Forecast

Graph 11.9
Expectation Index of Retail Sales Survey

(Percent)

Table 11.7
Planning and Projection of Government Price and Income Policies in 2003

Government Policy	Price/Tariff Increase	Implementation Period
Base Electricity Tariff	24	Each Quarter
Fuel Tariff	21	Quarter I
Cigarette Minimum Retail Price	12	Quarter IV
Telephone Tariff	15	Quarter I
Minimum Provincial Wages	7	Quarter I
Toll Tariff	50	Quarter I

administered prices, for example: the Base Electricity Tariff (TDL); retail prices for cigarettes (HJE); fuel; telephone tariffs; and provincial minimum wages (UMP) (Table 11.7 and 11.8).

- TDL is scheduled to rise by 6.0% every quarter starting in early 2003, which makes for around 24.0% in the whole 2003. Higher TDL is needed to overcome PLN's financial crisis.
- The government plans to raise revenues from excise taxes to Rp27.7 trillion from Rp22.5 trillion last year, by increasing the retail sales price of cigarettes by around 12.0%. A large price increase would be needed due to low volume growth in cigarettes sales in 2003. Otherwise, the excise tax target looks difficult to achieve. Also, there are plans to change the excise tax from ad valorem to semi-specific,[5] which has the potential to raise prices further.
- Almost all types of fuel (except solar and kerosene) are being adjusted to 100.0% of market prices. This adjustment is estimated to cause all fuel prices to rise on average by 21.0% in 2003. The impact of fuel prices on inflation is large because it can affect other prices, mainly in the transportation sector.
- The government plans to raise telephone tariffs by around 15.0% in 2003. This is part of the plan approved by the government and the House of Representatives (DPR) to raise the tariffs over 3 years (from 2002 to 2004) by 45.5%, that is an average increase of 15.0% per year. However, the structure by component indicates that the increase will be larger, namely around 30%. The largest increases will be in the local pulse tariff (33.3%)

(Rp/Litre)

Table 11.8
Fuel Price Comparation in 2002 and Fuel Price Forecast in 2003

Fuel Type	2002 Lowest Price	2002 Higher Price	2003 Lowest Price	2003 Higher Price
Premium	1,450	1,750	1,600	2,100
Automotive Diesel Oil	900	1,550	1,650	2,100
Industrial Kerosene	900	1,650	1,800	2,200
Diesel Oil	900	1,520	1,600	2,050
Marine Fuel Oil	800	1,150	1,150	1,600

5 Changing the calculation formula from a percentage into a specific rupiah amount per pack.

and routine subscription tariff (31%); the cost of long-distance calls will decline by 3.9%.

- There will also be a significant increase in toll road tariffs, by between 25%-75%. However, the weight of toll road tariffs in the CPI is very small (0.01%), so that the impact on CPI inflation will be insignificant.
- Government wage policy will impact on CPI inflation in 2003 due to rising minimum provincial wages (UMP), which are predicted to rise by 7.0%. The increase in UMP will increase the operational costs of companies and they may try to raise product prices in order to maintain their profit margins. Meanwhile, civil servants' salaries and teachers' allowances are set to increase by 10% and 50%, respectively, in 2003. This is not expected to have a significant impact on prices.

Medium-term Inflation Prospects

In the medium term, inflation is forecast to decline. This forecast is based on several factors that make for declining price pressure over the next several years, supported by Bank Indonesia's commitment to reduce inflation.

The inflationary impact of government policies is forecast to decline over the medium-term due to less intense measures in the years ahead. This stems mainly from government efforts to reduce the budget deficit through cuts to subsidies and increases in tax revenues. Also, the predicted stable exchange rate in the medium term also makes for price stability in the coming years. Moreover, international commodity prices are forecast to rise insignificantly and the implementation of AFTA could reduce domestic prices.

Eventually, these positive factors will also pull down the public's inflationary expectations. Similarly, Bank Indonesia's efforts to control inflation are expected to direct public expectations in the direction of lower inflation in the years ahead.

Banking Prospects

The main challenge in the banking sector is to revitalize the intermediation function of the banking system. Other challenges include: reaching the target for net Non-Performing Loans (NPLs) of 5.0% by June 2003; applying market risk in the calculation of Capital Adequacy Ratios (CAR) in early 2004; and reducing the guarantee program parallel with establishment of the Deposit Insurance Institution.

Despite many obstacles, bank intermediation is expected to improve in 2003, especially through lending to small- and medium-sized enterprises (SME). A survey[6] of 14 Systematically Important Banks (SIBs) indicates that SME credits extended by these banks are expected to reach Rp83.0 trillion in 2003. Another survey[7] indicates that 40 banks will expand credits on average by more than 50%, compared to 2002. The same survey indicates that, by usage in 2003, most new credits will be channeled to working capital and consumption; investment credit is forecast to rise insignificantly. The sectors absorbing most banking credits in 2003 will be trade, manufacturing and other services.

The share of credits to SMEs are forecast to rise in 2003 since most banks have made a policy of repositioning from corporate into retail lending. Credits

6 Survey conducted by Banking Research and Regulation Directorate (DPNP) of 14 SIBs on December 27, 2002, regarding expansion of credits in 2003.

7 DPNP survey of 83 banks on December 11, 2002.

to SMEs are projected to reach Rp42.3 trillion in 2003. This is in line with surveys showing that credit expansion in 2003 would be prioritized in favor of credits with ceilings up to Rp1.0 billion and Rp5.0 billion.

Although corporate lending will increase, its share in total lending is set to decline. This declining share is due to several factors, including: the big number of large debtors still in IBRA; banks need more time to switch lending from big customers to small- and medium-sized borrowers; and the on-going trauma of non-performing loans for several banks.

From the capital side, the industry-wide CAR is forecast to decline slightly although it will remain above 8%. This decline is due to increased risk facing earning assets as credits expand. Individually, several banks are predicted to have CARs below 8%, particularly banks with large exposure to changes in interest rates and exchange rates and to reductions in the quality of earning assets.

Another likely change in 2003 concerns the range of services offered by banks and non-banks and the desire of customers to obtain more financial services under one roof. Many banks are expected to offer insurance and mutual funds (reksa dana) and to offer new banking products and services, for instance, dual currency deposits, internet banking and mobile banking.

Risks and Uncertainties

Despite the general prospects for strengthened recovery of the Indonesian economy in 2003, particular risks and uncertainties, mainly in the wake of the Bali tragedy, deserve special mention. If not handled properly, these factors could damage the Indonesian economy. By contrast, if those risks can be neutralized, this could accelerate the recovery. On the external side, these risks include a deterioration of economic conditions in most developed countries and weak global investors' perceptions. On the domestic side, there is incomplete banking intermediation; a mushrooming of labor conflicts; low business confidence in the legal system; and potential political tensions in advance of the 2004 General Election.

Externally, the world economy is forecast to improve but the higher economic growth is largely accounted for by some developing countries in Asia. Economic growth in developed countries that are the traditional export markets of Indonesia (such as the US and Japan) will grow only modestly. Modest growth in these economies could weaken further, if political tensions in the Middle East are long-lasting and they significantly affect flows of international trade.

Heightened political tensions in the Middle East could deal another blow to global investment. Unfavorable geo-political developments could worsen investors' and trading partners' perceptions of the Indonesian economy. Loss of confidence on the part of the international community is partly reflected in the "war premium" imposed on Indonesia's foreign trading activity. This premium would raise transaction costs with trading partners and increase the reluctance of international investors to put their money into Indonesia.

On the domestic side, particular mention is in order concerning political developments and security conditions before the 2004 General Election. Uncertainties in this regard could raise political tensions. In the short-term, the exchange rate and inflation could be affected by a negative turn of events. In the long-term, persistent negative developments could cause a loss of public confidence, causing a downturn in consumption and investment.

Labor conflicts disturb business conditions; reduce productivity; cause layoffs; and reduce incomes. They can also trigger other social conflicts. Moreover, if wage increases are not accompanied by higher productivity, unit costs of production rise and that reduces the international competitiveness of Indonesian products.

Another domestic risk arises from dissatisfaction with the dispute settlement process concerning certain high-profile legal cases. These have caused the public to doubt the supremacy of law in some quarters of Indonesia. Such cases also reduce the government's credibility in implementation of good governance, which further discourages investors from bringing their capital into Indonesia.

Another risk concerns the recovery of banking intermediation. Despite stronger credit expansion in 2002, the increase falls well short of the real sector's needs. This holds back economic growth and reduces the effectiveness of monetary policy.

A related uncertainty is the plan to exit from the IMF program by the end of 2003. An appropriate strategy is needed to minimize the impact of this event, mainly as regards the fiscal and balance of payments accounts. In particular, policy measures are needed to cover fiscal and balance of payment gaps both through mobilization of foreign and domestic financing (Box : Consequences and Preparations in Facing the End of IMF Program by End-2003).

INFLATION TARGETING AND POLICY DIRECTION

Inflation Targeting

(Percent)

Table 11.9
Indicative Path of Medium Term Inflation Target

Target	Period			
	2003	2004	2005	2006
CPI Inflation	9	8	7	6

In early 2002, Bank Indonesia set a medium-term inflation target of 6%-7% to be reached by 2006. That target—and the time frame for reaching it—are considered optimal in the sense that inflation will be down to a sufficiently low inflation level over a sufficiently extended period that achieving the target would not hinder the Indonesian economic recovery.[8] Certain notable assumptions underlay this medium-term inflation target, namely: controlled levels of public demand; less intense measures concerning government prices and incomes policies; and a stable rupiah exchange rate.

Achieving the inflation target needs to be implemented through a gradual process of lowering annual targets to the medium-term target. One simple way is to lower the annual target in linear way, thereby supporting a reduction in the public's inflationary expectations. On this basis, the indicative path of the inflation target from 2003 to 2006 is presented in Table 11.9.

Since uncertainty is high in achieving this target, and taking into account the effectiveness of monetary policy in controlling inflation in the short-run, annual inflation could deviate from the indicative path to the inflation target. The short-run (annual) inflation targets allow for a margin of error due to unforseen events or shocks.

8 See Box : Fixing the Bank Indonesia Inflation Target, Bank Indonesia Annual Report 2001.

Based on the sources of inflation in 2003, Bank Indonesia can meet the indicative inflation target for 2003, namely 9%, without hindering the economic recovery. However, in the light of many uncertainties, the target needs to be accompanied by an acceptable margin of error, set in this case at 1%. Hence, the CPI inflation target range for 2003 is set at 9% (+/- 1%).

Monetary Policy Direction

a. Monetary policy will be aimed consistently at reaching the inflation target of 9% in 2003, which maintains the commitment to achieving the medium-term inflation target. Operationally, base money will be targeted at a rate that is consistent with the inflation target, while maintaining the momentum that has developed for lowering SBI rates. To this end, base money will be directed towards gradually achieving average growth of 13%, which is adequate to meet the real needs of the economy.

b. Under circumstances of excess liquidity in current banking condition, the achievement of base money target is forecast to be consistent with the effort of further reducing interest rates on monetary instruments. Taking into account a number of other factors (such as, the rigidity of credit interest rates and significant declines in core inflation), inflationary pressure brought on by further reductions in interest rates is expected to be mild. Lower interest rates send positive signals to business agents regarding the prospects for economic recovery. In addition to pushing down credit rates, lower rates on monetary instruments are expected to encourage the corporate sector to issue bonds as an alternative source of investment financing.

c. Operationally, the optimization of monetary instruments during 2002 needs to be maintained, including the use of foreign exchange intervention policy to absorb (sterilize) bank liquidity and to minimize fluctuations in the exchange rate. In the longer-term in this regard, Government Securities need to be considered as an alternative instrument to SBIs (Box: The SBI Scripless and Automatic Bidding System (ABS)). However, this strategy needs to consider the appropriate timing and magnitudes according to market conditions. The use of Government Securities as a monetary instrument in the secondary market also requires well prepared infrastructure and regulations on the auction system (outright and repos). Well-prepared infrastructure should ensure smooth transactions in the secondary market, which in turn could enhance the effectiveness of Government Securities as alternative monetary instruments. (Box: The On-Line Scripless Securities Settlement System (SSS)).

Banking Policy Direction

a. Bank Indonesia's policy on banking will continue to aim at a sound banking system. In this regard, the net NPLs ceiling of 5.0%, targeted for the end of June 2003, is achievable. Banks with net NPLs above 5.0% need to make a clear and concrete business plan on how to achieve the net NPLs ceiling of 5.0%.

b. Encouraging banks to continue raising their expansion of credits to the SME sector, since business prospects of this sector are very potential.

c. Establishing an Indonesian Banking Architecture, which will set as the policy direction for the national banking industry in anticipation of long term changes.(Box: Indonesian Banking Architecture).

d. Preparing the Blue Print for Financial System Stability covering the monitoring and surveillance of financial stability, crisis resolution, and various organizational issues (Box: Financial System Stability in Indonesia).

e. In 2003, banks need to prepare for implementation of market risks in the CAR formula, effective in 2004. The new CAR formula incorporating market risk would not change the prevailing minimum CAR of 8.0%.

f. Issuing implementation guidelines for banks' risk management. Hopefully, banks will be able to do their own risk management according to the standardized format to strengthen internal controls.

g. Preparing for the Deposit Insurance Institution, taking into account several factors such as bank restructuring, effective banking supervision, settlement procedures for problem banks and the lender of last resort.

h. In the sharia banking area, policy in 2003 would give priority to improving regulations and the supporting infrastructure for sharia banking development. On the regulation side, the improvement partly covers risk-based supervision, prudential regulation, sound assessment of sharia banking, improvement of reports, sharia bank accounting and audit standardization.

Payment System Policy Direction

a. In the cash payment area, policy will be aimed at fulfilling the public needs for currency through enhanced effectiveness of currency distribution. The head office process of channeling/distributing small denomination currency to the public (using outsourcing companies and BPRs) will be implemented in seven more branch offices. For areas where there is no Bank Indonesia branch office, the distribution of currency will be done through Kas Titipan (Cash Intermediation) in cooperation with local banks. Other policies concerning the cash payment system include expanding the network for handling counterfeit money.

b. In the non-cash payment system area, policy will be aimed at expanding the Real Time Gross Settlement (RTGS) system, reducing payment system risks, and reviewing the Blue Print of the National Payment System. By end-2003, all BI branch offices will be connected with the BI-RTGS system so that the Centralized Settlement Account (CSA) could be realized. To reduce payment system risk, Bank Indonesia is preparing a Bank Indonesia Regulation (PBI) regarding the implementation of a card-based payment system to meet product security standards and to have reliable information on the products and services offered to card holders. Review on National Payment System Blue Print begun in early 2002 and it will be continued in 2003 through a consultation and communication forum with external parties that are involved in expansion of the payment system.

box

The SBI Scripless and Automatic Bidding System (ABS)

Sertifikat Bank Indonesia (SBI) is short-term rupiah debt instrument issued by Bank Indonesia. Currently, they are the main instruments in the implementation of monetary policy through the open market operations (OMO). SBIs were first issued in 1984 based on the Presidential Decree No.5 1984 regarding the Issuance of SBIs and from Bank Indonesia Decision Letter No.16/55/Kep/Dir, 21 January 1984 on SBIs.

Rapid development of the Indonesian financial market requires innovations in the availability of appropriate instruments on a continual basis—together with the supporting infrastructure—to facilitate accurate, safe and secure transactions. Taking account of these issues, in late 2002 Bank Indonesia improved the SBI issuance and transactions mechanisms, based upon an electronic management system. Prior to late 2002, every SBI was accompanied by a printed certificate and that certificate was stored at Bank Indonesia. The owners of those notes are given a deposit slip (bukti depo simpanan; BDS) as proof of SBI ownership, managed by Bank Indonesia.

Improvements to this SBI system are provided for in PBI No.4/10/PBI/2002. Also, Bank Indonesia improved the implementation of monetary policy through PBI No.4/9/PBI/2002 regarding Open Market Operations. These two regulations were issued on November 18, 2002 and were effective on November 25, 2002. Those regulations were aimed at granting a clear legal basis for the status and function of SBIs in the conduct of monetary policy in Indonesia. The old regulations on SBI issuance were no longer appropriate in the light of changes in a dynamic financial marketplace.

The improvements to the SBI system cover scripless SBI issuance, which is to say the issuance of SBIs without a physical certificate. In this regard, the record of SBI ownership will be conducted through an electronic management system at Bank Indonesia.

This system is known as the Book Entry Registry (BER), and it is also used to manage government bond trading. In this regard, Bank Indonesia is acting as the central registry (CR) for management of SBI ownership by banks. There is also a sub-registry (SR) for management of SBI ownership by parties other than banks. Currently, there are 11 banks appointed in the SR. These appointments are conducted through a tight selection process based on criteria set by Bank Indonesia to guarantee that SR banks are able to carry out their function as an SBI scripless organizer according to standards set by Bank Indonesia. The criteria include experience in managing security notes for a minimum of 3 years; an average nominal value of securities managed in the last six months of Rp1 trillion; owning a secure scripless recording system that has been audited; and having a wide business network.

With this improved mechanism, SBI transactions (particularly on the secondary market) are expected to be conducted more efficiently. In addition, repo transactions (including for SBIs) are expected to develop, which will reduce interest rate volatility and segmentation in the financial market. It should be noted that in the secondary market, SBIs can be traded, both as repos or outright, and can be used as collateral.

Scripless SBIs have a unit denomination of Rp1,000,000.00 (one million rupiah). However, the minimum permitted transaction in the primary market (at the issuance through auction) is set at 1,000 units or Rp1,000,000,000.00 (one billion rupiah); increments are 100 units or Rp100,000,000.00 (one hundred million rupiah). Discount bidding is in incremental units of 0.0625%.

SBI issuance by Bank Indonesia could be implemented through an auction or non-auction mechanism. SBI buyers in the primary market are banks and other parties determined by Bank Indonesia. At this time, only banks can buy SBIs in the primary market through the auction mechanism. This is to protect the SBI function as a monetary instrument for affecting money market liquidity through changes in bank deposits at Bank Indonesia.

Primary market transactions can only be conducted through an automatic bidding system (ABS) from Bloomberg on-line and on a real-time basis. Previously, SBI bidding could be done by telephone, facsimile, or a Reuters monitor dealing system (RMDS). Through the ABS system, bidding, determination and announcement of auction winner, and confirmation of the auction results to bidders is conducted electronically. This makes for a faster process that is relatively safe from human error.

SBI bidding by banks that do not have access to an ABS system is conducted through other banks or money market brokers who own an ABS system. Currently, there are 40 banks and 7 money market brokers who own an ABS system.

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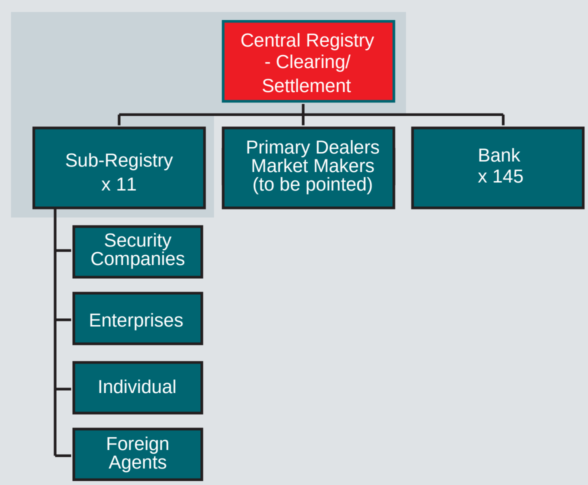
The On-line Scripless Securities Settlement System (SSSS)

Introduction

Government bonds were originally issued as part of the banking recapitalization program. Later these Bills became known as Government Securities (Surat Utang Negara or SUN) with the issuance of Act No.24, 2002 regarding SUN, and Bank Indonesia was appointed to manage these treasury notes. According to Article 55 Verse 3 in Act No 23, 1999, Bank Indonesia assists the Government in issuing the SUN. Previously, Bank Indonesia's role as the organizer of SUN was stated in the Joint Agreement between the Ministry of Finance and Bank Indonesia on May 28, 1999. In that Joint Agreement, Bank Indonesia was to act as organizing agent of SUN with tasks including: recording the ownership of SUN in the list of SUN holders; recording all changes of ownership, as approved by confirmed SUN record; and to pay SUN interest and principal as they fall due. Currently, the task of Bank Indonesia as SUN organizer covers the central registry, clearing, settlement and payment agent as stated in Article 12 Verse 1, Act No.24, 2002 regarding SUN.

To manage SUN, Bank Indonesia uses a system known as BI-SKRIP (Bank Indonesia Sistem Kliring, Regestrasi dan Penatausahaan Obligasi Pemerintah or Bank Indonesia Clearing System, Registry and Government Bond Management). This consists of a CR at Bank Indonesia and 11 SRs approved by Bank Indonesia. Since the recording in BI-SKRIP uses a two-tier system, those eligible to become customers of the CR are SRs, banks and market makers, and other parties appointed by Bank Indonesia. Corporations or individuals cannot become a customer of the CR; they can only become a customer of an SR. The BI-SKRIP structure could be described as follows:

Structure of Securities Registration in BI-SKRIP



To record ownership, Bank Indonesia as the CR uses the Book Entry Registry (BER) for SUN settlement in scripless trades. Since November 17, 2000 the BER system has been connected to the Bank Indonesia-Real Time Gross Settlement (BI-RTGS) system so that the settlement of SUN transactions (in the primary and secondary markets or government bond coupon payments falling due) can be implemented on-line. In this context, the BER system handles SBI settlements that are scriplessly traded; it also handles OMO settlements and later it will be used to handle SUN settlements.

The current system has many shortcomings. For example, connection of the BER system with agents in the CR is still conducted manually. Under this system, when a change in ownership of securities occurs, two documents (one to switch the registry associated with transferring securities ownership (SPPR), and the second, a settlement order (SPPP) to Bank Indonesia) are still delivered in hard copy by a courier. Similarly, the ownership report is delivered manually. In addition, the SR or bank cannot check on-line its outstanding position of security ownership. The ownership of securities could only be known based on daily or monthly confirmation of securities records submitted by the CR or SR.

This manual connection between Bank Indonesia as CR with banks, SRs or other domestic agents as direct customers of the CR, can cause various problems. For instance, delayed recording of transactions resulting from the late delivery of instruction to change securities' ownership; unsettled transactions according to the time limit resulting from errors in filling the application forms or security trading errors; and the late delivery of the report on security ownership to the sub-registry. Against this background, it is important to have an integrated interconnection between the CR and SR and other direct customers of the CR. Such a system is being developed by Bank Indonesia; it is known as the On-line Scripless Securities Settlement System (SSSS). Bank Indonesia plans to implement the SSSS for SUN and SBIs in September 2003.

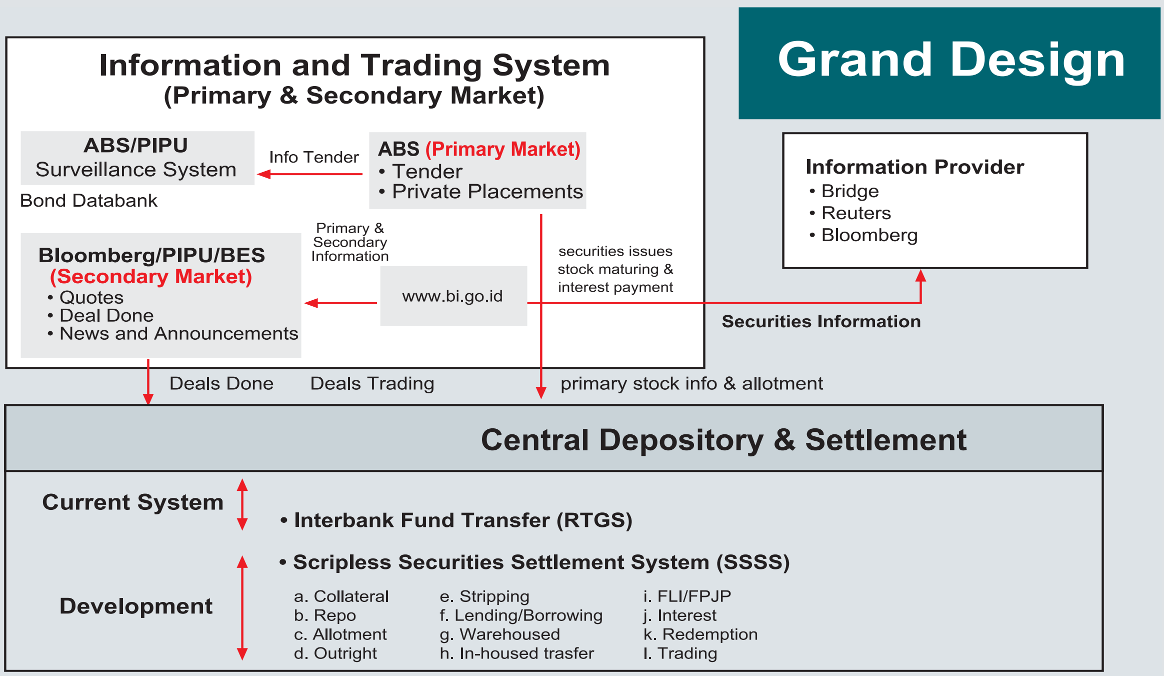
SSSS Grand Design

As planned, the SSSS will be connected with the BI-RTGS system acting as the fund settlement system. At a later date, the SSSS would settle various transactions and pay interest and principle as they fall due. SSSS would also be integrated with the ABS system (Box: The SBI Scripless and Automatic Bidding System (ABS)). To support market transparency, results of the SSSS settlement will be forwarded to various other information systems, such as Bank Indonesia's website, PIPU (money market information center), Bloomberg, Bridge System, Reuters and other information providers.

The Benefits of Using SSSS

The use of On-line SSSS has a number of advantages for the secondary securities market, including:

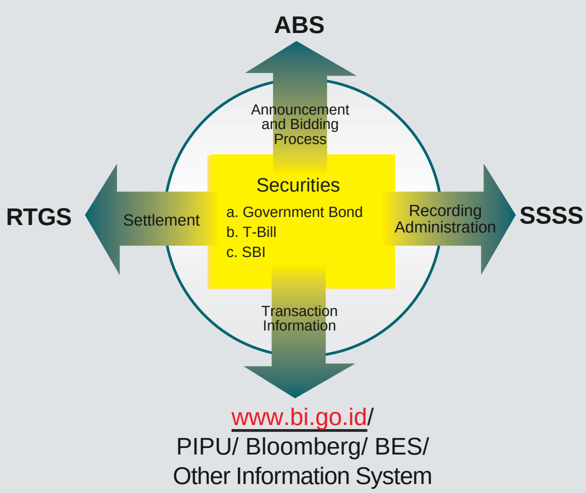
1. *Saving time, cost and human resources in transactions settlement*. By using the SSSS system, transactions are done on-line, not manually. Bank Indonesia, as CR and acting as the organizer of SSSS, does not have to perform manual settlement, and the payment settlement could be forward directly to the RTGS system.



Notes : - PIPU = Money Market Information Center
- BES = Surabaya Stock Exchange
- FLI = Intraday Liquidity Facility
- FPJP = Short-term Funding Facility

2. *Reducing security settlement risk in the secondary market with Delivery Versus Payment (DVP) principle.* The Bank for International Settlement (BIS) has recommended that bank settlements in money market transactions use the DVP principle to protect financial system stability.

Infrastructures of Securities Issuance and Administration



3. *Increasing trading in the secondary market for securities.* Low risk transactions will encourage market players to undertake more of the transactions. As a corollary, more secondary trading in SUNs or SBIs will make the market more liquid. Liquidity will also increase because SSSS is connected with the Indonesian Government Securities Trading System (IGSTS) which constitutes a SUN trading system used by the SUN Traders Association (Asosiasi Pedagang Surat Utang Negara/ APSUN) operated by the Surabaya Stock Exchange (Bursa Efek Surabaya/BES). This APSUN is an association with 15 banks active in SUN trading; connecting these two systems will increase the trading done among members of APSUN.

box

Consequences and Preparations in Facing the End of IMF Program by End-2003

Amid a deepening crisis in the second half of 1997, the Indonesian Government requested financial assistance from the IMF on 31 October 1997, for purposes of balance of payments support, recovery of market confidence, and stabilization of the rupiah. On November 5, 1997, the IMF Executive Board approved a Stand-By Arrangement (SBA) facility. This was subsequently changed into an Extended Fund Facility (EFF) in August 1998 and eventually into a new EFF in February 2000 in line with the deepening and broadening nature of the crisis.[1] By the end of 2002, Indonesia had received total loan commitments of $15.1 billion from the IMF, of which $13.2 billion had been disbursed and $4.4 billion had been repaid.[2] Consequently, at the end of 2002 Indonesia's outstanding loans from the IMF totaled $8.9 billion. The new EFF commitment is scheduled to end on December 31, 2003.

In return for IMF loan disbursements, Indonesia is obliged to fulfill IMF conditionality as stated in an agreement known as a Letter of Intent (LOI), designed in the context of the IMF Program. Primarily, the LOI serves as the benchmark for the IMF in its periodic reviews to decide whether to release further amounts of financial assistance. In practice, success by the debtor country in fulfilling its commitments in the LOI becomes a prime indicator for market agents and the international community (including the Consultative Group on Indonesia and the Paris Club) to measure the seriousness of the program country in implementing its economic recovery plan.

The Government of Indonesia plans to discontinue its IMF Program when it expires in late 2003. This raises several important questions. First, can Indonesia at the end of 2003 get approval from the IMF Executive Board to end its IMF Program, as in Korea and Thailand? Second, what consequences would Indonesia face by discontinuing its IMF Program? Third, what preparations should Indonesia undertake to minimize any shocks from ending its IMF Program?

According to prevailing IMF regulations, whether a country can legally end its IMF Program largely depends upon the IMF Executive Board. The Executive Board's decision is based upon its judgment as to whether the policies and economic conditions of the program country have shown significant improvement. By way of example, South Korea and Thailand were approved to exit from their respective IMF Programs on December 3, 2000 (Korea) and on June 19, 2001 (Thailand). While they exited from their programs, the two countries followed somewhat different paths. South Korea repaid all its IMF loans ahead of

1 The EFF is an IMF facility extended to member countries experiencing serious balance of payment deficits, such that external financing is needed with a relatively long-term repayment period, allowing structural economic reforms to take place.

2 Using the IMF exchange rate of 31 December 2002 of USD1.350952 per Special Drawing Right (SDR).

schedule, while Thailand continues to repay its loans according to the original repayment schedule. Taking into account the IMF guideline that faster repayment should only be implemented by a country with strong balance of payments and international reserves, an IMF exit scheme for Indonesia is likely to be more or less similar to that of Thailand. Although exiting in this manner would not involve further conditionality, the IMF Executive Board would still review the state of the Indonesian economy twice a year through a process called Post Program Monitoring (PPM).[3]

What are the consequences of exiting from the IMF Program at the end of 2003? The most important consequence concerns losing the opportunity for Indonesia to obtain further official debt rescheduling from the Paris Club. Only countries with an IMF Program (either an SBA or EFF) are eligible for debt rescheduling from the Paris Club. In addition, and taking into account that debt rescheduling under the Paris Club adheres to the principle of comparability of treatment for all Indonesia's creditors, debt rescheduling by the London Club would also be unlikely with the termination of the IMF Program.

In the meantime, data show that (bilateral and multilateral) program loans with policy conditions (usually in the form of a so-called 'policy matrix') linked to Indonesia's IMF Program, disbursed more funds in 2001 than other types of program loans.[4] This is evidence that doubts will arise among donor countries regarding Indonesia's ability to fulfill the policy matrices of future program loans without an IMF Program. This, in turn, would hinder program loan disbursements, which are very important for financing the fiscal deficit.

A second consequence of discontinuing the IMF Program concerns the emergence of a financing gap in the state budget due to the lost opportunity for more debt rescheduling from the Paris Club. The lost opportunity to obtain debt rescheduling from the Paris Club would— in 2004 alone—force the Government to seek alternative financing of up to Rp30 trillion to cover debt service payments in that year. Significantly more would be needed if exit from the IMF program also disturbs the flow of bilateral and multilateral program loans.

A third consequence of exit from the IMF Program will be the need for market agents and the international community to find alternative reference points for judging the state of the Indonesian economy. In this context, the crucial question is whether the Government of Indonesia, together with the House of Representatives (DPR) and Bank Indonesia, are able to formulate a coherent economic recovery policy and implement it consistently. If this were to take place, strong

3 Assuming that Indonesia will continue to drawdown its IMF loans during 2003 and repay according to a normal schedule, routine IMF review under this PPM scheme would be expected to continue until the end of 2008 at the latest, unless the IMF Executive Board were to decide otherwise.

4 Program loans are the largest category of loans in the Government of Indonesia's foreign debt.

Government credibility could serve as a reference point for market players and the international community. The alternative is declining confidence in the Indonesian economy.

A fourth consequence concerns the condition of Indonesia's balance of payments and foreign reserves upon exit for the IMF Program. Debt servicing of the IMF loans according to the normal schedule is forecast not to jeopardize the BOP and reserve position. The greater concern is that exit from the IMF Program might cause capital outflows in line with declining confidence of market agents and the international community towards the Indonesian economy. In such conditions, and even assuming that exports soon improved significantly, our BOP and reserve position would be facing difficulties in the subsequent few years.

In the light of these consequences, a number of steps would need to be taken as part of an IMF exit strategy at the end of 2003. The first important step for the Indonesian government is a full awareness that the government should enhance its ability to create a coherent policy framework and implement it consistently. In this regard, an important, early step would be to fully implement all policy commitments in the LOI for the rest of 2003 in a timely, consistent manner.

As a second step, the Indonesian Government must work hard to explore alternative financing sources to compensate for the loss of further debt rescheduling from the Paris Club and a likely decline in bilateral and multilateral program loans after exiting the IMF Program. Possible options include: increased tax revenues through a broader tax base; efficient spending through a shift from generalized price subsidies to targeted subsidies; re-profiling of government bonds; and issuance of securities in the domestic market, especially for refinancing maturing bonds. These are all possible alternatives that should be explored further. Another possibility is foreign bilateral debt rescheduling outside the Paris Club. The third step that should be implemented by the Government is to promote the development of a domestic market for Government bonds. This could be a valuable source of financing for the budget, and development of this market would help attract inflows of foreign portfolio investment. Such inflows would offset the outflows in the balance of payments resulting from the debt service payments to the IMF and the loss of Paris Club reschedulings.

The fourth important step by the Government is to build a strong, deep political commitment to recovery from the crisis and for its leaders to capably coordinate the exit from the IMF Program. The experiences of South Korea and Thailand provide Indonesia with a lesson on the importance of these two ingredients. Also, stable political and security conditions played a sizable role in the success of those two countries' exit from IMF Programs.

box

Indonesia's Banking Architecture

The banking crisis of 1997 has taught us important lessons and provided invaluable experience about the Indonesian banking system. Meanwhile, customers are expecting more complex banking products and services that may involve higher risks. Consequently, the national banking industry must be prepared to counter the potential risks inherent in the new innovative products. Adding to the complexity of the issue, the development of information technology has resulted in wider and faster distribution of products and services offered by financial institutions and banks, making these products available on a global basis. In the face of these changes and challenges, the national banking system must become stronger in order to compete fairly and reasonably in the domestic market and to be competitive internationally, in support of sustainable economic development.

To be helpful in this regard, some comprehensive reference framework is needed to point the direction for longer-term development of national banking. This purpose would be served by a Blueprint of the National Banking Architecture, which would include recommendations on policy directions by all parties involved in the banking industry.

Bank Indonesia is currently in the process of preparing Indonesia's Banking Architecture (Arsitektur Perbankan Indonesia or API) that can be used as a comprehensive, forward-looking platform for banking policy. The plan is to finalize the API by end of 2003, with gradual implementation between 2004 to 2014. This timeframe should provide ample time for the national banking industry to adjust to the policy recommendations. In preparing the API, Bank Indonesia has done many pieces of research and field assessments.

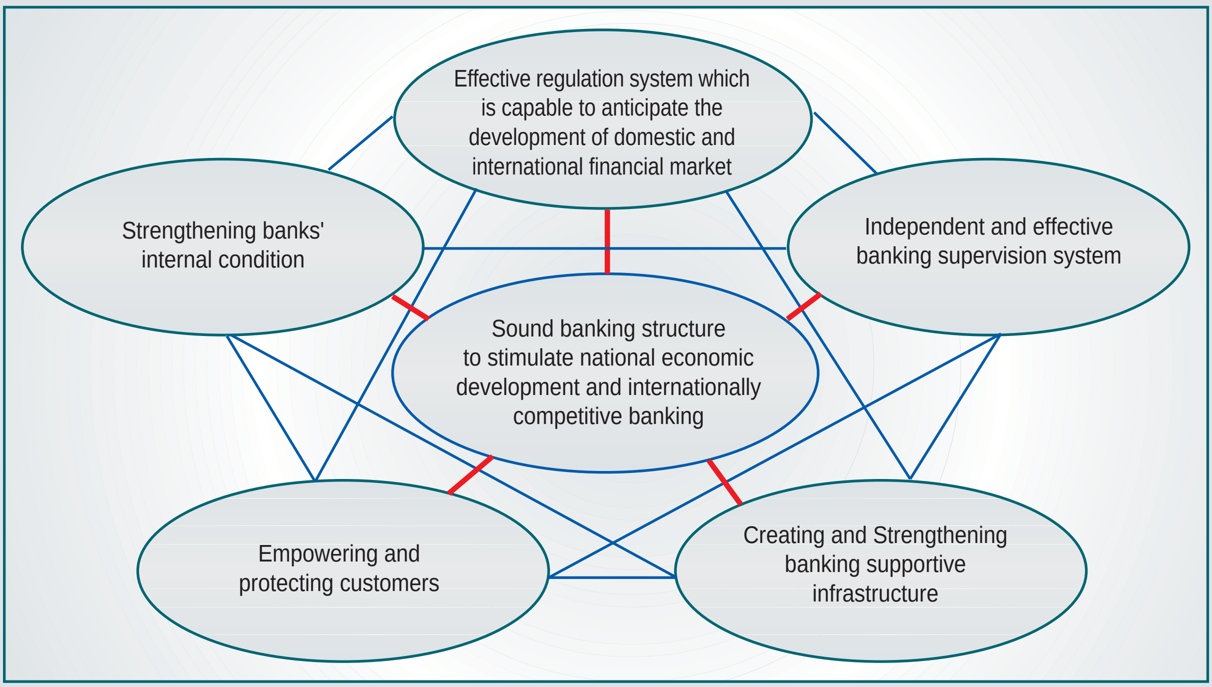
The vision of API is the creation of a sound, strong and efficient banking system to preserve financial system stability and stimulate national economic development. The objectives of API are:

1. To create a sound domestic banking structure with the capacity to meet public needs and to stimulate sustainable national economic development.
2. To create a strong banking industry that is highly competitive and has a solid core capable of absorbing shocks.
3. To apply principles of good corporate governance as a means to strengthen banks' internal conditions.
4. To have effective banking supervision and regulations that are consistent with international standards.
5. To have complete infrastructure in support of sound banking.
6. To empower and protect consumers of banking services.

The API grand design comprises six pillars that are inter-connected and mutually supporting (see Chart).

The central pillar (concerning the future banking structure) is the most important ingredient for strong and internationally competitive banking institutions. The other, supportive pillars have important roles in contributing to the creation of a sound and stable banking system.

Six Pillars of Indonesian Banking Architecture



box

Financial System Stability (FSS) in Indonesia

Introduction

The financial crisis of 1997 demonstrated dramatically that factors threatening overall financial stability—and not just those limited to any individual financial institution—need careful monitoring from the financial authorities, including the central bank. The crisis has also demonstrated that existing mechanisms for maintaining stability and handling crises were ineffective. In general, responsibility for maintaining domestic financial stability is only undertaken by Bank Indonesia (representing the monetary and banking supervision authorities) and the Ministry of Finance (representing the fiscal and non-bank financial institutions authority). Based on the experience of this crisis, ineffective efforts to maintain financial stability in Indonesia were partly due to the absence of any formal framework for maintaining financial system stability, including the available financial infrastructure, a conducive regulatory framework, and comprehensive means of crisis resolution.

Hence, some comprehensive, effective mechanism is required to maintain financial stability encompassing those elements. This issue prompted Bank Indonesia to undertake comprehensive steps in implementing its role in the preservation of financial stability. These steps are stated in the Blue Print for Financial System Stability (FSS), which covers in part organizational issues, the role of monitoring and surveillance, and crisis resolution.

Why FSS is Needed

There are several good reasons why financial system stability should be a priority for Bank Indonesia. First, crises in the financial system always have negative impacts on economic performance and entail large fiscal costs. The 1997 crisis not only affected the real sector; it also deteriorated into a multi-dimensional crisis, inclusive of socio-political dimensions. Second, for monetary policy, an unstable financial system causes structural problems for the central bank's monetary management. Bank disintermediation makes the monetary policy transmission mechanism ineffective in affecting the final target, namely inflation. Third, the central bank's function of creating a safe and smoothly functioning payment system is put at risk by financial system instability. Fourth, as lender of last resort (that is, as a temporary source of liquidity to prevent systemic risks), the central bank should monitor with great care the overall risks of financial instability.

The Coverage of FSS

In general, a financial system is classified as stable if its financial institutions are sound, regarding both their financial side and the risks they face. In such conditions, general confidence in financial institutions is high in the sense that they are perceived as able to fulfill their obligations. In addition, a stable financial system needs stable financial markets, that is, the financial market is not rocked by wide fluctuations in prices, especially those that do not reflect market fundamentals.

On this basis, and despite its dominant role in stabilizing the market, obviously Bank Indonesia is unable to realize financial system stability without active support from other key players in the financial infrastructure. Therefore, a clear division of labor and responsibility among existing institutions is vital, including among institutions that are not yet operational (such as, the Financial Supervisory Authority and the Deposit Insurance Institution). In this context, the role of each institution and its interrelations with other institutions in ensuring financial system stability should be arranged formally. In addition, an effective coordination framework—including intensive cooperation and harmonization among institutions—is badly needed.

The Role of Bank Indonesia in FSS

Based on practice in other countries, the general role of a central bank in financial system stability covers the following areas:

- Conducting financial system surveillance.

- To coordinate financial system stability policies with other relevant authorities. This role is implemented in cooperation with other agencies that also have responsibility for supervising institutions and financial markets.

- Providing assistance in crisis resolution, including through the lender of last resort mechanism.
- Creating a safe and robust payment system, partly through payment system oversight.
- Ensuring cooperation and coordination with other authorities, since financial system stability is not solely the responsibility of the central bank.
- Following a conducive monetary policy.

To this end, Bank Indonesia will, in the near future, take the initiative to implement several financial stability functions, which are reflected in Bank Indonesia's internal organization. These include aspects of research, monitoring, regulation and crisis prevention and crisis resolution.

The research function constitutes an important component that will become a core task of Bank Indonesia in execution of the FSS function. The research will include coverage of the financial institutions; money and capital markets; macroeconomic policies; fiscal policy; the corporate and household sectors; the payment system; foreign and domestic debts; and international financial markets.

The surveillance function is aimed at monitoring all indicators that could affect financial stability. In general, these can be classified into two sub-categories, namely the micro and macro aggregate indicators. They include financial institutions; the capital market; the real sector; international markets; fiscal and monetary policy; foreign and domestic debt; and the payment system.

The regulation function concerns establishment of the regulatory framework, regulations, standardization and guidelines for banks and other financial institutions to operate on a sound prudential basis. The role of Bank Indonesia in regulatory and standardization procedures relates to macro prudential considerations and the monetary and payment systems. In principle, the Financial System Stability Unit, a new unit within Bank Indonesia, will support other working units, both internally and externally, by making recommendations on related sectoral policies.

As a reference for crisis prevention, agreement has been achieved in many international forums to implement international standard regulations sponsored by institutions, such as the IMF, the BIS, and practitioner associations (see Figure). These standards and regulations will also be used as benchmarks by Bank Indonesia in setting up the framework for financial system stability.

With regard to crisis resolution, experience has shown the need for a settlement procedure, accompanied by a clear role and well-defined responsibilities for each institution. In the event that the crisis is driven by a problem in one bank/ financial institution, the procedures should clearly mention the following:

- The authority of related institutions in identifying an institution/bank as having the potential to trigger systemic failures
- The procedures to save an institution/bank

FINANCIAL STABILITY FORUM

12 Key Standards for Sound Financial Systems

Macroeconomic Policies & Data Transparency

1. Code of Good Practice of Transparency in Monetary and Financial Policies
2. Code of Good Practice in Fiscal Transparency
3. Data Dissemination Standard

Institutional & Market Infrastructure

1. Principles of Corporate Governance
2. Core Principles for Systemically Important Payment System
3. Market Integrity (Financial Action Task Force/FATF on Anti Money Laundering)
4. Insolvency
5. International Accounting Standard (IAS)
6. International Standard on Auditing (ISA)

Prudential Financial Regulation & Supervision

1. Core Principles for Effective Banking Supevision
2. Principles of Securities Regulation
3. Core Principles for Insurance Supervision

that is hit by crisis according to the Law regarding the mobilization of public funds. And,

- The role of the central bank, the supervisory authority and the Government in handling financial sector crises still needs to be clarified.

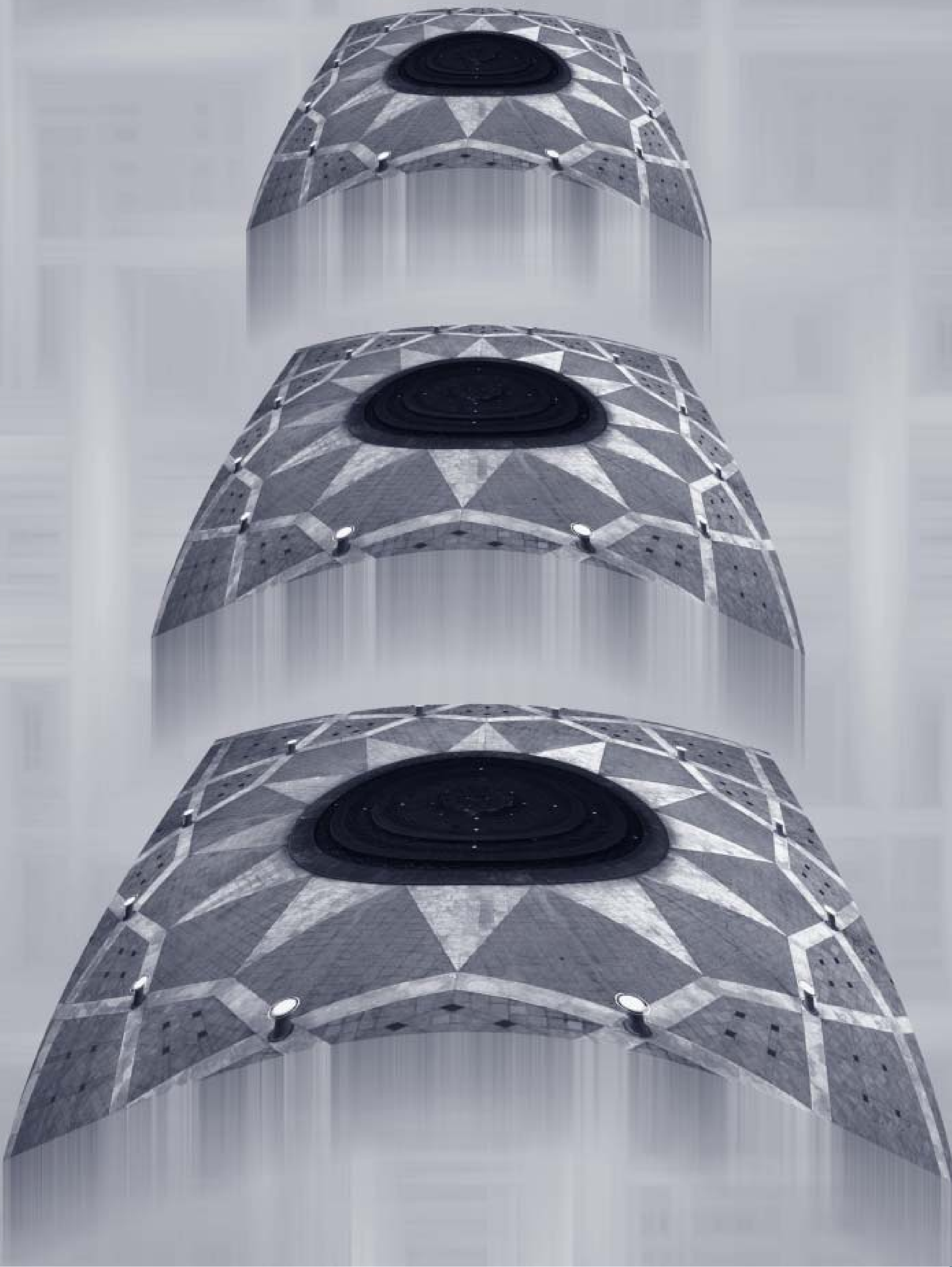
In several countries (including the UK and Australia) a standing committee consisting of the Central Bank, the Supervisory Authority and the Government is established to discuss the problems to be handled by an authorized institution.

Another important aspect is coordination among authorities. Currently, authority and responsibility is fragmented among several groups, including: the monetary authority; the financial institution and capital market supervision authority; the deposit insurance institution; and the government as fiscal authority. More coordination among these agencies is badly needed.

Various issues will emerge related to coordination and cooperation among these authorities, partly regarding the distribution of information. For instance, the performance of individual banks that could cause systemic problems, and various aggregate indicators of financial institutions, such as solvency, liquidity and NPLs. One possible approach to the coordination issue would be interlocking management between the Central Bank and the Financial Supervisory Authority. Also, a Standing Financial Stability Committee (comprising the Central Bank, Financial Supervisory Authority and the Government) could be established to maintain routine coordination among these institutions. Cooperation and coordination among these institutions should be stated in the law, or at least to be part of a clear memorandum of understanding (MoU).

Annual Report

Appendices



Appendix A

BANK INDONESIA

Head Office

Jakarta

Representative Offices

London
New York
Singapura
Tokyo

Branch Offices

Ambon, Balikpapan,
Banda Aceh, Bandar Lampung,
Bandung, Banjarmasin, Batam, Bengkulu, Cirebon
Denpasar, Jambi, Jayapura, Jember, Kediri, Kendari,
Kupang, Lhokseumawe, Makassar, Malang, Manado, Mataram,
Medan, Padang, Palangkaraya, Palembang, Palu, Pekanbaru,
Pontianak, Purwokerto, Samarinda, Semarang,
Sibolga, Solo, Surabaya, Tasikmalaya,
Ternate, Yogyakarta

Appendix B

Board of Governors of Bank Indonesia

As of December 31, 2002

Governor

Syahril Sabirin

Senior Deputy Governor

Anwar Nasution

Deputy Governor

Miranda S. Goeltom

Aulia Pohan

Bun Bunan E.J. Hutapea

Maulana Ibrahim

Maman H. Somantri

Aslim Tadjuddin

Appendix C.1

Organization and Human Resources

During 2002, Bank Indonesia made several improvements in its organization and programs for human resource development. The improvements in organization are to meet the internal and external needs for Bank Indonesia's development and to realize the mission of Bank Indonesia. In support of the government securities market, efforts have been made to develop securities management through the On-Line Scripless Security Settlement System (SSSS). This system will be integrated with the Bank Indonesia-Real Time Gross Settlement (BI-RTGS) and market agent systems so that Centralized Depository and Settlement is created within Bank Indonesia. To this end, the organizational structure and main tasks of the Monetary Management Directorate have changed, namely by establishing a Securities Management Development Team.

In the Payment System area, in the context of the Core Principles for Systematically Important Payment System (CPSIPS) and the Law of Consumer Protection, supervision has been widened. To improve focus, supervision tasks formerly under the Team of Regulation and Supervision of the National Payment System have been shifted to a new working unit under the Accounting and Payment System Directorate. It will be called the Division of Payment System Supervision.

To implement comprehensive structural change, Bank Indonesia is currently conducting a Bank Indonesia Transformation Program. This program, which is being undertaken gradually, has entered the implementation stage with seven strategic programs, namely: i) the Planning, Budgeting and Performance Management Project; ii) the Human Resources Management Project; iii) the Banking Project, iv) the Information Management Project; v) the Information Technology Project; vi) the Monetary Project; and vii) the Logistical Project. The implementation of each project is conducted by the Special Unit for Transformation, following a diagnostic study of each previous step.

The first realization of several strategic programs is the Human Resources Management Project. Improvements in this regard are conducted by changing the authority and responsibility of Human Resource Management, by promoting the role of Line Managers in developing the human resources in the Line Manager's own working unit. In parallel, improvements have been made in the Human Resource Directorate with a new role for strategic partners and "agent of change among the staff" in Bank Indonesia.

To realize the mission of Bank Indonesia, and simultaneously achieve objectives of the Management Information Project, a Special Unit for Information Management (Unit Khusus Manajemen Informasi or UKMI) has been established. UKMI has a vision to prepare a strategy and implement effective, efficient Bank Indonesia Management Information based on the needs of the stakeholders. The UKMI function is to act as formulator and director of Bank Indonesia

Information Management; adviser and manager of information at the operational level; and coordinator of supporting activities in information management performance.

To promote human resources with strategic values and high motivation and performance in realizing Bank Indonesia's mission, on-going improvements have been undertaken in the Human Resource Management System.

During 2002, a regulation on Enhancing the Quality and Skills of Personnel Abroad has been implemented. This will enhance personnel capability according to job and rank, so as to ease their tasks, widen their horizons and promote organizational productivity and the motivation of personnel to work.

In addition, a regulation on personnel recruitment has been improved in order to meet the need for competent human resources to support the achievement of organizational objectives, covering recruitment at all levels. The basic principle in recruitment is transparency and objectivity in selecting personnel.

Another important aspect of Human Resources Management is the Personnel Promotion system. This promotion system is aimed at filing each empty position at a given rank with a person (who satisfies promotional requirements) from one rank lower. This is done in order to raise personnel motivation; to appreciate those who are eligible for the right job; and to promote the careers of those with distinction and the potential to be nominated as candidates for organization leaders. Promotion is conducted with reference to the human resource planing program.

To realize Bank Indonesia's vision to become an accountable institution domestically and internationally, staff personnel are required to work according to strategic values covering principles of competence, integration, transparency, accountability and collegiality. For this reason, regulations have been set up regarding the payment of honorarium in Bank Indonesia. This regulation prohibits Bank Indonesia personnel from receiving honorarium payments during their duty with

Number of Personnel

No.	End of Financial Year	Head Office	Regional Offices	Representative Offices	Total
1	1997/1998	3,341	2,882	67 [1)]	6,290
2	1998/1999	3,299	2,852	21	6,172
3	1999/2000	3,068	2,601	17	5,686
4	2000/2001	3,123	2,615	18	5,756
5	Jan. 2002	3,119	2,556	18	5,693
6	Jan. 2003	2,971	2,480	14	5,465

[1)] Including those studying abroad

Bank Indonesia, when the honorarium originates in the Bank Indonesia budget. In addition, personnel staff are prohibited from receiving honorarium payments (during his/her job with Bank Indonesia) from third parties when the funds are obtained from Bank Indonesia's budget.

To carry out tasks and authority in a clean manner and free of corruption, collusion, and nepotism, the Board of Governors is required to submit reports regarding their wealth to the Examining Commission to Inspect Wealth of the State Executives according to prevailing laws. Internally, Bank Indonesia has issued a Board of Governors' Regulation confirming the obligation to submit the concerned report to that Commission. It also requires every Bank Indonesia Executive Personnel up to a certain rank to report their wealth and liabilities to the Governor of Bank Indonesia.

Head Office

Directorate of Economic Research and Monetary Policy	:	Hartadi A. Sarwono
Directorate of Economic and Monetary Statistics	:	-
Directorate of Monetary Management	:	Tarmiden Sitorus
Directorate of Reserve Management	:	Made Sukada
Directorate of International Affairs	:	Ny. Veronica W.S.P.
Bureau of Credit	:	Roswita Roza
Directorate of Banking Research and Regulation	:	Nelson Tampubolon
Directorate of Bank Licensing and Banking Information	:	M. Ashadi
Directorate of Bank Supervision 1	:	Aris Anwari
Directorate of Bank Examination 1	:	Baridjussalam Hadi
Directorate of Bank Supervision 2	:	Ny. Siti Ch. Fadjrijah
Directorate of Bank Examination 2	:	Ardhayadi M.
Directorate of Rural Bank Supervision	:	Abdul Salam
Directorate of Currency Circulation	:	Budiman Kostaman
Directorate of Accounting and Payment System	:	Mohamad Ishak
Directorate of Logistics and Security	:	Dede Ariffin S.
Directorate of Information Technology	:	Bambang Sindu W.
Directorate of Human Resources	:	Abdul Azis
Directorate of Internal Financial Management	:	Sumantri Supono
Directorate of Legal Affairs	:	-
Directorate of Internal Audit	:	Harmain Salim
Office of The Governor	:	Rusli Simanjuntak
Office of The Secretariat	:	Djarot Sumartono
Special Unit For Banking Investigation	:	Mohammad Ali Said K.
Center of Education and Central Banking Studies	:	Halim Alamsyah
Bureau of Islamic Banking	:	Harisman
Special Unit For Transformation Program (UKPT)	:	Romeo Rissal
Special Unit for Information Management (UKMI)	:	Dibyo Raharjo

Representative Offices

Singapore	:	Ilham Ikhsan
Tokyo	:	-
London	:	Rasmo Samiun
New York	:	Maman Hendarman

Branch Offices

Category I

Bandung	:	Djoko Sarwono
Medan	:	Bambang Setijoprodjo
Semarang	:	Bachri Ansjori
Surabaya	:	Nana Supriana

Category II

Bandar Lampung	:	Imrandani
Banjarmasin	:	M. Zaeni Aboe Amin
Denpasar	:	Lukman Boenjamin
Manado	:	Hadi Hassim
Padang	:	M. Djaelani Soegiarto
Palembang	:	Irman Djaja Dalimi
Makassar	:	Djoko Sutrisno
Yogyakarta	:	Amril Arief

Category III

Ambon	:	Rachman Abdulkadir
Banda Aceh	:	Yusmanazir Katin
Cirebon	:	Tjahjo Oetomo K.
Jambi	:	Erman Kurnandi
Jayapura	:	Sahat Tampubolon
Malang	:	Sentot Purnomo
Mataram	:	Satria Mulya
Pekanbaru	:	Mahmud
Pontianak	:	Rusli Sembiring
Samarinda	:	Prabowo
Solo	:	Adiastopo Joko Purnomo

Category IV

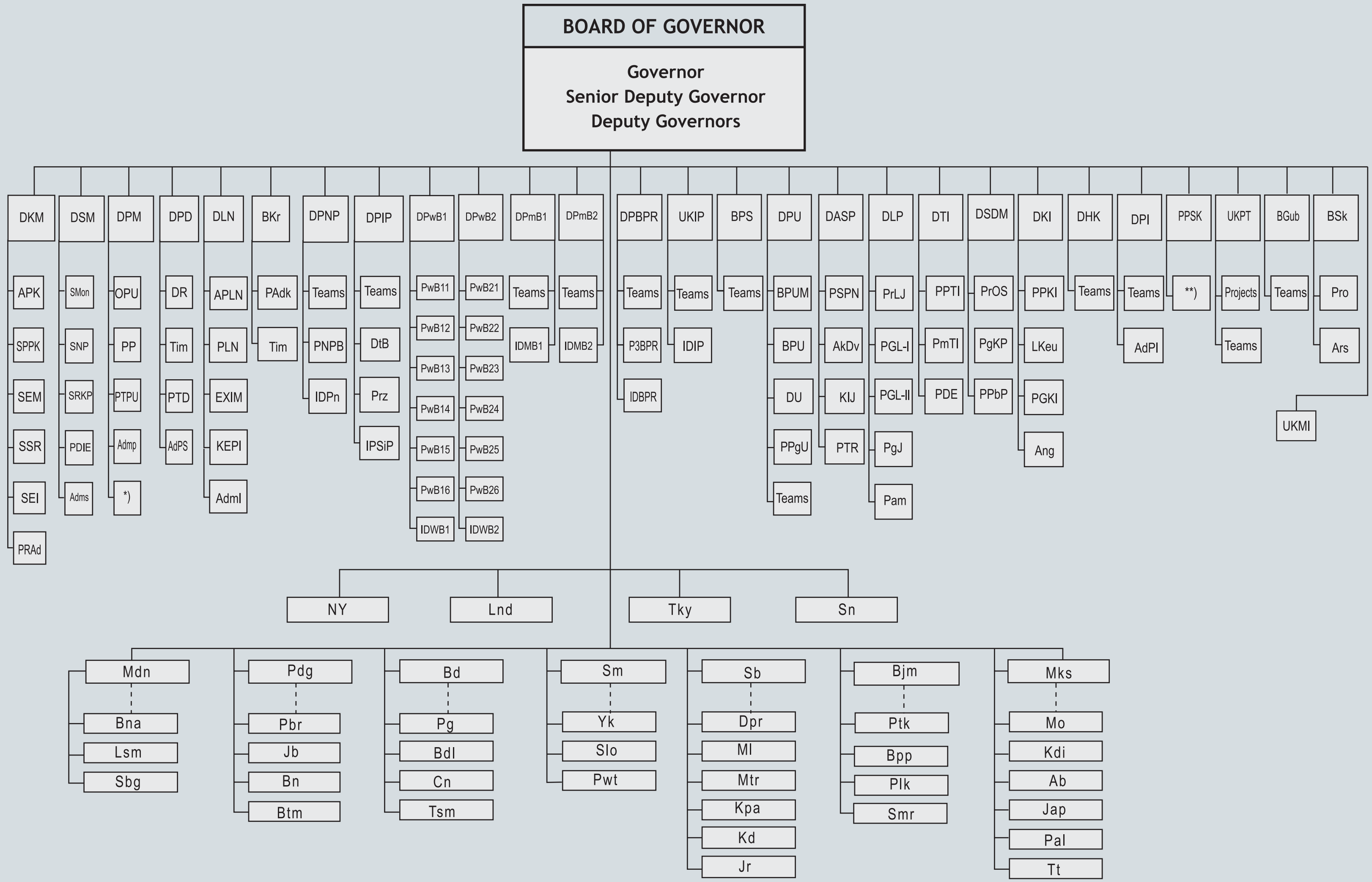
Balikpapan	:	Matsisno
Kupang	:	Dikan
Jember	:	Sutikno
Kediri	:	Imbang Setiamihardja
Purwokerto	:	Wiyono
Tasikmalaya	:	Moch. Zaenal Alim
Palangkaraya	:	Bramono Sidik
Bengkulu	:	Joko Wardoyo
Kendari	:	Mokhammad Dakhlan
Palu	:	J. Wiwoho

Category V

Batam	:	I Made Sudja
Sibolga	:	Yasin Effendi
Lhokseumawe	:	Fachrurrazi
Ternate	:	Muh. Abdul Fadlil

Appendix C.2

ORGANIZATION CHART OF BANK INDONESIA



Notes :

*) Securities Management Development Team

**) Research Group

Head Office of Bank Indonesia

No.	Directorates and Divisions	Abbreviations
I.	**DIRECTORATE OF ECONOMIC RESEARCH AND MONETARY POLICY**	**DKM**
	1. Policy Analysis and Planning Division	APK
	2. Financial Market Structure Studies Division	SPPK
	3. Macro Economic Studies Division	SEM
	4. Real Sector Studies Division	SSR
	5. International Economic and Institution Studies Division	SEI
	6. Research Library and Administration Division	PRAd
II.	**DIRECTORATE OF ECONOMIC AND MONETARY STATISTICS**	**DSM**
	1. Monetary Statistics Division	SMon
	2. Balance of Payment Statistics Division	SNP
	3. Real Sector and Government Finance Statistics Division	SRKP
	4. Economic and Monetary Data and Information Processing Division	PDIE
	5. Administration Division of Economic and Monetary Statistics	Adms
III.	**DIRECTORATE OF MONETARY MANAGEMENT**	**DPM**
	1. Money Market Operation Division	OPU
	2. Money Market Development Division	PPU
	3. Money Market Settlement Division	PTPU
	4. Securites Management and Development Team	-
	5. Money Market Administration Division	Admp
IV.	**DIRECTORATE OF RESERVE MANAGEMENT**	**DPD**
	1. Dealing Room	DR
	2. Risk Management Team	-
	3. Economic Analysis and Reserve Regulation Team	-
	4. Reserve Settlement Division	PTD
	5. Administration and Treasury System Maintenance Division	AdPS
V.	**DIRECTORATE OF INTERNATIONAL AFFAIRS**	**DLN**
	1. Foreign Debt Administration and Analysis Division	APLN
	2. Foreign Debt Division	PLN
	3. Export and Import Division	EXIM
	4. International Trade and Economic Cooperation Division	KEPI
	5. Administration Division of International Affairs	AdmI
VI.	**BUREAU OF CREDIT**	**BKr**
	1. Credit Management and Administration Division	PAdk
	2. Research and Development Team	-
VII.	**DIRECTORATE OF BANKING RESEARCH AND REGULATION**	**DPNP**
	1. Teams	-
	a. Banking Regulation Team	
	b. Bank Supervision Development Team	
	2. Banking Research Bureau	PNPB
	3. Information and Documentation Division of Banking Research and Regulation	IDPnP

No.	Directorates and Divisions	Abbreviations
VIII.	**DIRECTORATE OF BANK LICENSING AND BANKING INFORMATION**	**DPIP**
	1. Bank Liquidation Team	–
	2. Banking Data Division	DtB
	3. Bank Licensing Division	Prz
	4. Information and Banking Information System Development Division	IPSiP
IX.	**DIRECTORATE OF BANK SUPERVISION 1**	**DPwB1**
	1. Bank Supervision Division 11	PwB11
	2. Bank Supervision Division 12	PwB12
	3. Bank Supervision Division 13	PwB13
	4. Bank Supervision Division 14	PwB14
	5. Bank Supervision Division 15	PwB15
	6. Bank Supervision Division 16	PwB16
	7. Information and Documentation Division of Bank Supervision 1	IDWB1
X.	**DIRECTORATE OF BANK SUPERVISION 2**	**DPwB2**
	1. Bank Supervision Division 21	PwB21
	2. Bank Supervision Division 22	PwB22
	3. Bank Supervision Division 23	PwB23
	4. Bank Supervision Division 24	PwB24
	5. Bank Supervision Division 25	PwB25
	6. Bank Supervision Division 26	PwB26
	7. Information and Documentation Division of Bank Supervision 2	IDWB2
XI.	**DIRECTORATE OF BANK EXAMINATION** 1	**DPmB1**
	1. Bank Examiner Teams	-
	2. Information and Documentation Division of Bank Examination 1	IDMB1
XII.	**DIRECTORATE OF BANK EXAMINATION 2**	**DPmB2**
	1. Bank Examiner Teams	-
	2. Information and Documentation Division of Bank Examination 2	IDMB2
XIII.	**DIRECTORATE OF RURAL BANK SUPERVISION**	**DPBPR**
	1. Teams	-
	a. Rural Bank Supervision Teams	
	b. Rural Bank Deposit Insurance and Liquidation Team	
	2. Rural Bank Licensing, Research and Regulation Division	P3BPR
	3. Information and Documentation Division of Rural Bank Supervision	IDBPR
XIV.	**SPECIAL UNIT FOR BANKING INVESTIGATION**	**UKIP**
	1. Banking Investigation Teams	-
	2. Information and Documentation Division of Banking Investigation	IDIP
XV.	**ISLAMIC BANKING BUREAU**	**BPS**
	1. Teams	–
	a. Islamic Banking Research and Regulation Team	
	b. Islamic Bank Supervision Team	
	c. Islamic Banking Licensing and Administration Team	
XVI.	**DIRECTORATE OF CURRENCY CIRCULATION**	**DPU**
	1. Cash Deposit Division	BPUM
	2. Cash Withdrawal Division	BPUK
	3. Currency Distribution Division	DU

No.	Directorates and Divisions	Abbreviations
	4. Currency Procurement Division	PPgu
	5. Currency Research, Planning and Regulation Team	–
XVII.	**DIRECTORATE OF ACCOUNTING AND PAYMENT SYSTEM**	**DASP**
	1. National Payment System Development Bureau	PSPN
	2. Foreign Exchange Accounting Division	AkDv
	3. Jakarta Clearing Division	KIJ
	4. Rupiah Settlement Division	PTR
	5. Payment System Supervision Division	PwSP
XVIII.	**DIRECTORATE OF LOGISTICS AND SECURITY**	**DLP**
	1. Logistics and Services Planning Division	PrLJ
	2. Logistics Management Division I	PgL-I
	3. Logistics Management Division II	PgL-II
	4. Services Management Division	PgJ
	5. Security Division	Pam
XIX.	**DIRECTORATE OF INFORMATION TECHNOLOGY**	**DTI**
	1. Information Technology Research and Development Bureau	PPTI
	2. Information Technology Maintenance Division	PmTI
	3. Electronic Data Processing Division	PDE
XX.	**DIRECTORATE OF HUMAN RESOURCES**	**DSDM**
	1. Strategic Planning Team	-
	2. Consultation Team	-
	3. Implementation Team	-
XXI.	**DIRECTORATE OF INTERNAL FINANCIAL MANAGEMENT**	**DKI**
	1. Corporate Financial Planning and Controlling Bureau	PPKI
	2. Financial Report Division	LKeu
	3. Salary and Corporate Financial Administration Division	PGKI
	4. Budget Division	Ang
XXII.	**DIRECTORATE OF LEGAL AFFAIRS**	**DHk**
	1. Teams	–
	a. Legal Advisor Team	
	b. Legal Information and Documentation Team	
	c. Enquiry Point Team	
XXIII	**DIRECTORATE OF INTERNAL AUDIT**	**DPI**
	1. Teams	
	a. Internal Audit Development Team	
	b. Regulation Analysis Team	
	c. Audit Teams	
	2. Administration and Information Division of Internal Audit	AdPI
XXIV.	**CENTER OF EDUCATION AND CENTRAL BANKING STUDIES**	**PPSK**
	Research Group	
XXV.	**SPECIAL UNIT FOR TRANSFORMATION PROGRAM**	UKPT
	1. Projects	–
	2. Program Office Team	

No.	Directorates and Divisions	Abbreviations
XXVI.	**SPECIAL UNIT FOR INFORMATION MANAGEMENT**	**UKMI**
XXVII.	**OFFICE OF THE GOVERNOR**	BGub
	1. Teams	-
	a. Planning and Monitoring Team	
	b. Public Relation Team	
	c. Governor Staff	
XXVIII.	**OFFICE OF THE SECRETARIAT**	**Bsk**
	1. Protocol Division	Pro
	2. Archives Division	Ars

Branch Offices and Representative Offices	Abbreviations
Representative Offices	
1. New York	NY
2. London	Lnd
3. Tokyo	Tky
4. Singapura	Sn
Branch Offices	
1. Ambon	Ab
2. Balikpapan	Bpp
3. Banda Aceh	Bna
4. Bandar Lampung	Bdl
5. Bandung	Bd
6. Banjarmasin	Bjm
7. Batam	Btm
8. Bengkulu	Bn
9. Cirebon	Cn
10. Denpasar	Dpr
11. Jayapura	Jap
12. Jambi	Jb
13. Jember	Jr
14. Kediri	Kd
15. Kendari	Kdi
16. Kupang	Kpa
17. Lhokseumawe	Lsm
18. Makassar	Mks
19. Malang	Ml
20. Mataram	Mtr
21. Medan	Mdn
22. Manado	Mo
23. Padang	Pdg
24. Palangkaraya	Plk
25. Palembang	Pg
26. Palu	Pal
27. Pekanbaru	Pbr
28. Pontianak	Ptk
29. Purwokerto	Pwt
30. Samarinda	Smr
31. Semarang	Sm
32. Sibolga	Sbg
33. Solo	Slo
34. Surabaya	Sb
35. Tasikmalaya	Tsm
36. Ternate	Tt
37. Yogyakarta	Yk

Appendix D.1

Bank Indonesia
Balance Sheet
as of December 31, 2002 and December 2001[1)]
(in Million Rupiah)

Assets		Dec 31, 2002 *Unaudited*	Dec 31, 2001 *Audited*
1.	Gold	9,506,255	8,933,494
2.	Foreign Currencies	13,770	450,286
3.	Special Drawing Rights	146,425	165,030
4.	Demand Deposits	**4,399,928**	**11,235,351**
4.1	Central Banks	2,915,790	8,382,950
4.2	Correspondent Banks	1,484,138	2,852,401
5.	Time Deposits at Correspondent Banks	53,837,138	69,063,460
6.	Marketable Securities	**225,395,171**	**209,867,886**
6.1	In Rupiahs	0	0
6.2	In Foreign Exchanges	225,395,171	209,867,886
7.	Claims		
7.1	On Government	**351,069,970**	**315,927,999**
	7.1.1 In Rupiahs	351,043,888	315,897,657
	7.1.2 In Foreign Exchanges	26,082	30,342
7.2	On Banks	**17,954,492**	**19,182,702**
	7.2.1 In Rupiahs	16,894,621	17,949,743
	7.2.2 In Foreign Exchanges	1,059,871	1,232,959
7.3	On Others	**8,001,652**	**7,537,529**
	7.3.1 In Rupiahs	8,001,652	7,537,529
	7.3.2 In Foreign Exchanges	0	0
8.	Allowance for Bad Debt	(48,837,112)	(49,753,871)
9.	Equity Participation	229,474	229,474
10.	Other Assets	9,835,639	9,357,393
Total Assets		**631,552,802**	**602,196,733**

Liabilities and Equities		Dec 31, 2002 *Unaudited*	Dec 31, 2001 *Audited*
A.	**Liabilities**		
1.	Currency in Circulation	98,418,806	91,275,606
2.	Demand Deposits		
2.1	Government	**103,244,759**	**85,651,638**
	2.1.1 In Rupiahs	61,813,103	48,684,295
	2.1.2 In Foreign Exchanges	41,431,656	36,967,343
2.2	Banks	**44,983,701**	**41,887,382**
	2.2.1 In Rupiahs	38,326,357	34,668,559
	2.2.2 In Foreign Exchanges	6,657,344	7,218,823
2.3	Other Private Sectors	**924,775**	**798,236**
	2.3.1 In Rupiah	795,363	671,321
	2.3.2 In Foreign Exchanges	129,412	126,915
2.4	Internasional Financial Institution	**79,990,532**	**95,791,501**
	2.4.1 In Rupiah	79,990,532	95,791,501
	2.4.2 In Foreign Exchanges	0	0
3.	Bank Indonesia Certificate	**112,801,184**	**102,143,747**
3.1	In Rupiahs	112,801,184	102,143,747
3.2	In Foreign Exchanges	0	0
4.	Loans from Government	**34,327,302**	**31,476,677**
4.1	In Rupiahs	278,055	350,007
4.2	In Foreign Exchanges	2,322,720	2,679,045
4.3	Bank Indonesia Bond	31,726,527	28,447,625
5.	Foreign Borrowings	16,972,012	19,776,825
6.	Other Liabilities	6,120,818	999,211
Total Liabilities		**497,783,889**	**469,800,823**
B.	**Equities**		
1.	Capital	2,948,029	2,948,029
2.	General Reserves	20,584,751	8,233,006
3.	Statutory Reserves	8,822,036	3,528,431
4.	Fixed Assets Revaluation Reserves	4,865,933	4,871,249
5.	Exch Rate & Foreign Security Revaluations Reserve	26,338,170	50,204,504
6.	Government Bond Indexation Reserves	75,334,510	48,575,749
7.	Bank Indonesia Bond Indexation Reserves	(6,428,782)	(3,610,407)
8.	Previous Year Surplus	0	0
9.	Current Year Surplus	1,304,264	17,645,349
Total Equity		**133,768,913**	**132,395,910**
Total Liabilities and Equities		**631,552,802**	**602,196,733**

1) a. The Financial Report of Bank Indonesia in 2001 has been audited by the Supreme Audit Authority according to report No.01/01/Auditama II/GA/V/2002, May 8, 2002 with qualified opinion on claim account due to Bank Indonesia Liquidity Support (BLBI)
b. The Comprehensive Financial Report of Bank Indonesia in 2002 was submitted to Supreme Audit Authority through the letter No.5/1/GBI/DKI, dated January 31, 2002 to be audited.
c. Bank Indonesia Dollar/Rupiah Rate as of December 31, 2002: \$1 = Rp8.940,00 and as of December 31, 2001: \$1 = Rp10.400,00.

Appendix D.2

Bank Indonesia
Surplus Deficit Statement
For the Period Januari 1 – December 31, 2002 dan 2001
(In Million Rupiah)

		2002 *Unaudited*	2001 *Audited*
Revenues			
1.	**Monetary Operations**	**30,749,171**	**63,462,682**
1.1	Foreign Exchange Management	21,583,762	55,040,311
1.2	Money Market Activities	3,879	3,889
1.3	Loan and Financing	9,161,530	8,418,482
2.	**Payment System Services**	58,455	42,163
3.	**Banking Supervision**	24,743	46,811
4.	**Others**	**639,925**	**178,461**
4.1	Other Revenues	92,625	178,461
4.2	Allowance for Bad Debt Recovery	547,300	0
	Total Revenues	**31,472,294**	**63,730,117**
Expenses			
1.	**Monetary Operations**	**(26,891,306)**	**(21,075,424)**
1.1	Formulating and Implementing Monetary Policy	(18,384,897)	(15,407,479)
1.2	Foreign Exchange Management	(8,506,409)	(5,667,945)
2.	**Payment System Services**	**(1,038,354)**	**(718,498)**
2.1	Currency Circulation	(992,027)	(679,537)
2.2	Payment System Sponsoring	(46,327)	(38,961)
3.	**Banking Supervision**	**(69,768)**	**(52,505)**
4.	**General and Administration**	**(2,168,602)**	**(24,238,341)**
4.1	General, Administration and Others	(153,387)	(138,339)
4.2	Fixed Assets Depreciation	(2,542)	(2,542)
4.3	Allowance for Bad Debts	0	(22,068,133)
4.4	***Beban Umum, Administrasi dan lainnya***	(2,012,673)	(2,029,327)
	Total Expenses	**(30,168,029)**	**(46,084,768)**
Surplus Before Extraordinary Items		1,304,264	17,645,349
Extraordinary Expenses		0	0
SURPLUS		**1,304,264**	**17,645,349**

Appendix E.1

List of Bank Indonesia Regulations in 2002

Nr.	PBI Number	Date	Gazette	Description
1	4/1/PBI/2002	March 27	LN Thn 2002 No. 14 TLN No. 4177	To fulfill the rising public needs for sharia banking services, Bank Indonesia issued a regulation (PBI) regarding the change in activity oriented from conventional commercial bank into commercial banks based on sharia principles and the openings of bank offices based on sharia principles by conventional commercial banks.
2	4/2/PBI/2002	March 28	LN Thn 2002 No. 15 TLN No. 4178	Monitoring on foreign exchange flows is strongly required to support the application of free foreign exchange system. The monitoring could be implemented through the statistic foreign exchange activities, mainly through the balance of payments statistics and the outstanding foreign investments in Indonesia. In this regard Bank Indonesia issued PBI regulation regarding the monitoring on the foreign exchange activities of non-financial corporations. The obligation to submit report on foreign exchange activities of non-financial corporations with minimum total assets of Rp100,000,000,000.00 (one hundred billion rupiah) or have a minimum annual transaction volume of Rp100,000,000,000.00 (one hundred billion rupiah). This PBI also regulates sanction/punish those who do not submit a complete or untrue report and also those who are late in submitting the report.
3	4/3/PBI/2002	June 6	LN Thn 2002 No. 65	Revocation and withdrawal of Coins in denomination of Rp5 1970 and 1974 mintages, Rp25 1971 mintages, Rp50 1971 mintage, and Rp100 1973 and 1978 mintages.

Nr.	PBI Number	Date	Gazette	Description
4	4/4/PBI/2002	June 10	LN Thn 2002 No. 68	Revocation of Bank Indonesia Board of Directors Decree No. 31/201/KEP/DIR, dated 29 January 1999 as stated in the Joint Decree between the Minister of Finance and Bank Indonesia Governor No. Kep-046/KM.17/1999 and No. 31/201/KEP/DIR concerning the Export Guarantee Program in Supporting the Real Sector Recovery. During the crisis period, the Indonesian economic condition was not conducive, hence, affecting the banking sector performance. In line with gradual recovery process, bank intermediation started to improve without government guarantee program. In that regard, the Government and Bank Indonesia discontinued the export guarantee program, except for import L/C and working capital credit which are still under the Export Guarantee Program including those classified under the ongoing credits scheme and not yet undue and those falling due but has not been repaid. For these two schemes, this Joint Decree will be no longer effective by the end of the L/C import settlement and the working capital credit is repaid
5	4/5PBI/2002	August 8	LN Thn 2002 No. 86	Issuance and circulation of a special rupiah denomination of 500,000 and 25,000 on the series of “One Hundred Year of Bung Hatta”, 2002 mintage.
6	4/6/PBI/2002	September 6	LN Thn 2002 No. 91 TLN No. 4223	Changes in Decision Letter of Bank Indonesia Board of Directors No. 31/147/KEP/DIR dated November 12, 1998 regarding the Earning Assets. This change is aimed at recovering the certain regional economic conditions experiencing economic shocks. Those areas including the Province of Nangroe Aceh Darussalam, Maluku, Papua, the District of Sambas in West Kalimantan, District of East Kotawaringan at Central Kalimantan, and District of Poso at Central Sulawesi.

Nr.	PBI Number	Date	Gazette	Description
7	4/7/PBI/2002	September 27	LN Thn 2002 No. 97 TLN No. 4228	Banks are obliged to apply the cautious principles and risk management in purchasing credits from IBRA. Purchase of credits by banks from IBRA shall be conducted with normal price. This PBI regulates punishments towards violations against the PBI regulations. Banks who are purchasing credits from IBRA in 2002 before the issuance of this PBI should adjust themselves with the regulations under this PBI.
8	4/8/PBI/2002	October 10	LN Thn 2002 No. 104 TLN No. 4231	As concerned to the issuance of Law No. 15, 2002 regarding Criminal Act on Money Laundering, all regulations regarding the requirements and procedure to bring in or bring out the rupiah into/from the Republic of Indonesia should be adjusted. This PBI revokes PBI No. 3/18/PBI/2001 and regulates that each individual bringing out the rupiah currency of Rp100,000,000.00 or more from the area of the Republic of Indonesia should obtain Bank Indonesia's approval. On the contrary, each individual bringing in Rp100,000,000.00 or more into the Republic of Indonesia should examine the authenticity of the currency to Tax and Duty Office at the arrival place. This PBI also sanction/punish those who violate this PBI.
9	4/9/PBI/2002	November 18	LN Thn 2002 No. 126 TLN No. 4243	This PBI revokes 2 (two) Decision Letter of Bank Indonesia Board of Directors, namely No. 21/53/KEP/DIR dated October 27, 1998 regarding the Trading of Money Market Securities, and No. 23/84/KEP/DIR dated February 28, 1991 regarding the management of Discount Facility I, and aimed at improving the regulation on Open Market Operation (OMO) in supporting Bank Indonesia objectives in maintaining and achieving the rupiah value stability through monetary control mainly OMO. The OMO is aimed at reaching the operational target of monetary policy based on base money and its component targets or short term interest rate target. OMO is conducted through the

Nr.	PBI Number	Date	Gazette	Description
				issuance of SBI, buying and selling rupiah securities including SBI, Government Bills and other high quality notes and liquid; rupiah facility deposits with Bank Indonesia (FASBI); and buying and selling the foreign exchange. This PBI also regulates sanctions/punishments on violations against this PBI.
10	4/10/PBI/2002	November 18	LN Thn No. 127 TLN No. 4244	To implement monetary policy through the Open Market Operation (OMO), Bank Indonesia issued a PBI regarding Serfikat Bank Indonesia (SBI) which is managed electronically by Bank Indonesia in supporting the effectiveness and efficient of OMO. SBI has several characteristics, partly including the denomination unit of Rp1,000,000.00 (one million rupiah) with maturity of no less than 1 month and maximum of 12 months stated in terms of the number of days and is counted from the settlement day up to the falling due period. This PBI also sanctions/punishes the violations against this PBI.
11	4/11/PBI/2002	December 20	LN Thn 2002 No. 135 TLN No. 4248	The Bali Tragedy on October 12, 2002 is forecast to have an impact on the economy, especially at the Bali Province. Debtors who are affected by this tragedy is forecast to have difficulties in paying back their credits accordingly. Bank Indonesia is of the opinion to support the recovery process, partly by granting a special treatment to credits extended to small scale businesses financed by commercial banks within the area of Bali Province.

Appendix E.2

Bank Indonesia Circular Letters (Extern) in 2002

Nr.	No. BI Circular Letter	Date	Issues
1	4/1/DPBR	January 24	The Status of Bank Perkreditan Rakyat/BPRs (Credit Rural Banks) under Special Surveillance and Frozen Business Classification.
2	4/2/DASP	February 11	Long Distance Information System.
3	4/3/DASP	February 11	The change in SE No. 2/9/DASP dated June 8, 2002 regarding the Costs of Clearing Transaction.
4	4/4/DASP	March 1	The change of SE No. 2/25/DASP dated November 17, 2000 regarding the Cost of Using the BI-RTGS System.
5	4/5/DASP	March 28	Report on Foreign Exchange Activities by Non-Financial Institutions.
6	4/6/DPM	April 25	The Determination of Third Parties Fund Interest Rate Guaranteed by the Government.
7	4/7/DASP	May 7	The Implementation of Automated Local Clearing Activities.
8	4/8/DASP	May 13	The change in SE BI No. 3/28/DASP dated December 12, 2001 regarding the Use of Courier Services and The Clearing Staff Identification Card during the Implementation of Automated and Electronics Clearing Activities.
9	4/9/DPM	June 26	Determination of Third Parties Deposits Interest Rate Margin Guaranteed by the Government.
10	4/10/DASP	June 26	Second revision of Bank Indonesia Circular Letter No. 2/24/DASP dated November 17, 2000 regarding Bank Indonesia Real Time Gross Settlement.

Nr.	No. BI Circular Letter	Date	Issues
11	4/11/DASP	August 13	The Correlation between Demand Deposit Account of Bank Indonesia with External Parties.
12	4/12/DASP	September 24	Clearing Schedule and Final Settlement Date of Foreign Exchange, Local Clearing and Types and Limit of Nominal Notes or Electronics Financial Data.
13	4/13/DASP	September 24	Cost of Clearing Transaction.
14	4/14/DASP	September 24	Cost of Using the BI-RTGS System.
15	4/15/DASP	September 30	The Implementation of Electronics Local Clearing.
16	4/16/DASP	October 21	Local Clearing on Checks and Deposit Slips from Areas outside the Clearing Region.
17	4/17/DASP	November 7	Change in SE No. 2/10/DASP dated June 8, 2000 regarding the Management of Bad Checks/Deposit Slips Withdrawal.
18	4/18/DPM	November 18	The implementation and Settlement of Rupiah Bank Indonesian Deposit Facility (FASBI) in view of Open Market Operation (OMO).
19	4/20/DPM	November 18	The Issuance, Trade and Management of SBIs.
20	4/2/DASP	December 2	Long Distance Clearing Information System.
21	4/22/DPM	December 17	Change in SE No. 27/17/UPG dated May 10, 1994 regarding the Money Market Information Center.

Appendix E.3

Regulation and Important Policies in Economic and Finance in 2002

Date	Regulation/Policy	Number
January		
15	Change in Decisions of Director General of Tax and Duty No. Kep-63/BC/1997 regarding The Establishment and Procedure of Inflows and Outflows of Goods to and from the Trading Zone.	Decree of Director General of Customs and Excise No. KEP-03/BC/2002
16	The Government Determined the Retail Price of Domestic Fuels.	Presidential Decree No. 9, 2002
	Policy on Banking Rehabilitation and Corporate Debt Restructuring based on the Minutes of the Meeting on Financial Sector Policy.	Decree of Financial Sector Committee No. KEP.01/ K.KKSK/01/2002
29	Improvements in the Decree of Ministry of Tourism, Postal and Communications No. 79/PR.301/MPPT-95 regarding the Adjusted Base Tariff on Domestic Telecommunication Services.	Decree of The Minister of Transportation No. KM. 12, 2002
31	Changes on the Attached Decree of Ministry of Industry and Trade No. 558/MPP/Kep/12/1998 regarding the General Regulation in Exports after Several Revisions with the Decree of Ministry of Industry and Trade No. 294/MPP/Kep/10/2001.	Decree of The Minister of Industry and Trade No. 57/ MPP/Kep/1/2002
February		
1	The Mechanism and Formulation of Domestic Commercial Airlines' Passengers Tariff under Economic Class.	Decree of The Minister of Transportation No. KM. 8, 2002
6	The Trading Regulations for Tin Exports.	Decree of Director General of Foreign Trade No. 02/ DJPLN/KP/II/2002

Date	Regulation/Policy	Number
18	The Value Added Tax and Sales Tax on Luxurious Goods for Own Use and or Free Grant on Taxable Goods and or Tax on Services.	Circular Letter of Director General of Taxation SE-04/PJ.51/2002
26	Formula for VAT on Tobacco.	Decree of The Minister of Finance No. 62/KMK.03/2002
28	VAT on Final Output of Tobacco.	Decree of Director General of Taxation No. KEP-103/PJ.51/2002
	The Wave on VAT for Imports and or Certain Taxable Goods and or Certain Taxable Services.	Circular Letter of Director General of Taxation No. SE-07/PJ.51/2002
March		
23	Tax on Interest Earnings or Discounted Bonds traded and/or Trading Volume Reported in the Stock Exchanges.	Government Regulation No. 6, 2002
28	Tax Treatment on Income after Tax on Certain Business Entity.	Decree of The Minister of Finance No. 113/KMK.03/2002
April		
3	The Takeover/transfer of Ownership on Opened Company.	Decree of Head of Capital Market Supervisory Agency No. KEP-05/PM/2002
9	Tariff Formula for Services on Loading/Unloading Goods from and to the Ship at the Sea Port.	Decree of The Minister of Transportation No. KM. 25, 2002
17	The Act of Money Laundering.	Law No. 15, 2002

Date	Regulation/Policy	Number
23	Change on Ministry of Finance Decree No. 448/KMK.017/2000 regarding Finance Company.	Decree of The Minister of Finance No. 172/KMK.06/2002
	The Injection of Capital Participation of the Republic of Indonesia into the Capital of PT.Pelabuhan Indonesia III.	Government Regulation No. 17, 2002
30	Change in The President of the Republic of Indonesia Decree No. 9, 2002 regarding the Retail Price of Domestic Fuels.	Presidential Decree No. 27, 2002
May		
6	Divestment of the Recap Regional Development Banks.	Decree of The Minister of Finance No. 211/KMK.06/2002
7	Determination of Revenue Sharing on Natural Resources, Oil and Gas, General Mining and Fishery to Regions.	Decree of The Minister of Finance No. 214/KMK.06/2002
13	The Determination on the Sale Value of Taxable Land and Buildings.	Government Regulation No. 25, 2002
	Change in The Republic of Indonesia's Capital Participation in the Capital Stock of PT Merpati Nusantara Airlines.	Government Regulation No. 29, 2002
16	The Sale of the Republic of Indonesia's Ownership at PT Indosat, Tbk (or Divestment of PT Indosat, Tbk).	Government Regulation No. 30, 2002
23	Regulation on Exports of Sand Ocean.	Decree of The Minister of Industry and Trade No. 441/MPP/Kep/5/2002
24	The Conversion from the Preferred Stocks Owned by the State at PT. Bank Bukopin into Common Stocks.	Decree of The Minister of Finance No. 249/KMK.06/2002

Date	Regulation/Policy	Number
June		
5	The Formula of Subsidy Payments on Fuels.	Decree of The Minister of Finance No. 274/KMK.06/ 2002
6	Revocation on Bank Indonesia Board of Directors Decision Letter No. 31/201/KEP/Dir dated January 29, 1999 as Stated on the Join Decree between the Minister of Finance and Bank Indonesia Governor No. KEP-046/KM.17/1999 and No. 31/201/KEP/DIR regarding the Export Guarantee Program in Revitalizing the Real Sector.	Bank Indonesia Regulation No. 4/4/PBI/2002
10	The Trade Regulation on Imported Raw Sugar.	Decree of The Minister of Industry and Trade No. 456/ MPP/Kep/6/2002
13	Public Claims on Housing Credits Extended by Bank Tabungan Negara.	Decree of The Minister of Finance No. 301/KMK.01/ 2002
	Consideration on Release and Discharge for Government and Public Institutions.	Decree of The Minister of Finance No. 302/KMK.01/ 2002
	Revocation on the Ministry of Finance Decree No. 335/KMK.01/ 2000 regarding the Crash Program on Public Claims on Banking Debts as Stated in the Revision of the Minister of Finance Decree No. 505/KMK.01/2000.	Decree of The Minister of Finance No. 303/KMK.01/ 2002
	The Reduction of Import Duties on Certain Products.	Decree of The Minister of Finance No. 307/KMK.06/ 2002

Date	Regulation/Policy	Number
July		
5	Regulation on Clove Imports.	Decree of The Minister of Industry and Trade No. 528/MPP/Kep/7/2002
16	Guidance to determine the Cost of Regional Tax Collection.	Decree of The Minister of Home Affairs No. 35, 2002
23	Coordinating Team to Smooth the Flows of Export and Imports of Goods.	Presidential Decree No. 54, 2002
24	The Establishment of Anti Dumping Duty on Imported Wheat Flour.	Decree of The Minister of Industry and Trade No. 546/MPP/Kep/7/2002
29	Restructuring of Credits for Small and Medium Scale Businesses.	Presidential Decree No. 56, 2002
August		
7	Inland and Water Transportation Services that are free from VAT.	Decree of Director General of Taxation No. KEP-307/PJ./2002
11	Policy Recommendation to Speed Up the National Economic Recovery.	Decree of People's Consultatice Assembly No. 11/MPR/2002
14	Contract Guidance for Reksa Dana Company.	Decree of Head of Capital Market Supervisory Agency No. KEP-14/PM/2002
	Guidance for Reksana Dana Collective Investment Portfolio.	Decree of Head of Capital Market Supervisory Agency No. KEP-15/PM/2002

Date	Regulation/Policy	Number
	Contract Guidance for Collective Investment Portfolio.	Decree of Head of Capital Market Supervisory Agency No. KEP-16/PM/2002
	The Obligation to Submit Routine Financial Report.	Decree of Head of Capital Market Supervisory Agency No. KEP-17/PM/2002
	Management Guidance for Reksa Dana Company.	Decree of Head of Capital Market Supervisory Agency No. KEP-13/PM/2002
22	Tax Treatment on Guarantee Funds for Stocks Settlement.	Decree of Director General of Taxation No. KEP-390/ PJ./2002
23	Determination on the Volume of Ocean Sands Eligible For Exports in 2002.	Decree of The Minister of Industry and Trade No. 598/MPP/Kep/7/2002
September		
6	Change on Bank Indonesian Board of Directors Letter No. 31/ 147/KEP/DIR dated November 12, 1998 regarding Banks' Earning Assets.	Bank Indonesia Regulation No. 4/6/PBI/2002
27	Cautious Principles in Purchasing Credits by Banks from IBRA.	Bank Indonesia Regulation No. 4/7/PBI/2002
October		
18	The Change in Name of PT Bank Bali Tbk into PT Bank Permata.	Decree of The Board of Governors of Bank Indonesia No. 4/162/KEP/DpG/ 2002

Date	Regulation/Policy	Number
21	The Formula and Subsidy Payments on Electricity.	Decree of The Minister of Finance No. 431/KMK.06/2002
22	The Act of Government Securities.	Law No. 24, 2002
	Limit on Textile Imports.	Decree of The Minister of Industry and Trade No. 732/MPP/Kep/10/2002
30	Time Delay for Imported Machine, Goods and Raw Material that Obtain Special Facility based on the Minister of Finance Decree No.135/KMK.01/2002 regarding the Lower Import Duty on Machines, Goods and Raw Material for Development of Manufacturing Industry and Services Industry.	Decree of The Minister of Finance No. 456/KMK.04/2002
November		
12	Bond Issuance for Pawnshops Company.	Government Regulation No. 59, 2002
18	The Implementation and Settlement on Rupiah Bank Indonesia Deposit Facility or FASBI in the Open Market Operation.	Circular Letter of Bank Indonesia No. 4/18/DPM
19	Free Import Duty on Raw Material Components to make Equipment Network by Telecommunication Industry.	Decree of The Minister of Industry and Trade No. 474/MPP/Kep/01/2002
December		
12	Business Solution Center.	Decree of The Minister of Industry and Trade No. 802/MPP/Kep/12/2002
24	General Stock Bidding in Foreign Currency.	Decree of Head of Capital Market Supervisory Agency No. KEP-23/PM/2002

Date	Regulation/Policy	Number
30	Release and Discharge to Debtors who have Settled their Obligations or Law Enforcement on Debtors who have not settled their obligations based on the Settlement Obligations of Shareholders.	Presidential Instruction No. 8, 2002
31	Administration Sanctions to Importers.	Joint Decree of The Minister of Finance No. 527/KMK.04/2002 and The Minister of Industry and Trade No. 819/MPP/Kep/12/2002
	Retail Price of Domestic Fuels.	Presidential Decree No. 90, 2002

Table 16
Inflation Rates in 43 Cities
(percent)

Cities	1998 1)	1999 2)	2000	2001	2002
Lhokseumawe	79.66	6.61	8.73	11.67	10.99
Banda Aceh	79.01	5.57	10.57	16.60	10.14
Padang Sidempuan	85.72	-0.14	3.95	9.84	10.18
Sibolga	85.01	1.65	6.95	8.66	11.58
Pematang Siantar	80.23	-0.54	4.67	13.55	9.41
Medan	83.81	1.68	5.90	15.50	9.49
Padang	87.20	4.23	10.99	9.86	10.22
Pekanbaru	75.86	4.35	10.34	14.65	11.66
Batam	52.89	-0.28	9.00	12.64	9.14
Jambi	72.31	0.49	8.40	10.11	12.62
Palembang	89.18	-1.01	8.49	15.15	12.25
Bengkulu	84.10	0.47	8.21	10.58	10.11
Bandar Lampung	85.22	3.34	10.18	12.94	10.32
Jakarta	74.42	1.77	10.29	11.52	9.08
Tasikmalaya	73.55	1.58	4.57	16.71	10.29
Serang/Cilegon	65.43	-0.04	7.03	12.75	9.68
Bandung	72.59	4.29	8.52	11.91	11.97
Cirebon	62.23	4.75	6.52	12.93	10.53
Purwokerto	80.93	0.99	10.02	11.76	8.77
Surakarta	66.38	0.46	7.89	15.58	8.64
Semarang	67.19	1.51	8.73	13.98	13.56
Tegal	67.73	1.11	7.85	11.26	11.27
Yogyakarta	77.46	2.51	7.32	12.56	12.01
Jember	84.95	3.16	10.35	13.92	9.75
Kediri	77.08	-0.64	7.05	15.91	8.87
Malang	93.16	1.49	10.62	12.45	9.74
Surabaya	95.21	0.24	10.46	14.13	9.15
Denpasar	75.11	4.39	9.81	11.52	12.49
Mataram	90.50	0.59	5.19	14.76	7.96
Kupang	62.58	10.65	10.62	12.34	9.77
Pontianak	78.85	4.49	8.34	10.60	8.61
Sampit	75.94	-4.98	11.87	14.69	7.59
Palangkaraya	74.65	-0.13	8.57	13.35	9.18
Banjarmasin	74.43	1.47	7.57	8.36	9.18
Balikpapan	75.10	3.01	10.67	10.82	11.38
Samarinda	68.31	3.69	11.91	10.21	10.26
Manado	74.24	7.41	11.41	13.30	15.22
Palu	95.18	3.58	8.41	18.73	13.36
Makasar	80.86	1.64	9.73	11.77	8.25
Kendari	97.79	1.29	11.25	12.56	10.35
Ternate	72.98	0.38	14.51	13.71	6.40
Ambon	75.82	8.26	8.52	14.12	9.47
Jayapura	61.83	3.49	10.23	14.00	13.91
National Inflation	**77.63**	**2.01**	**9.35**	**12.55**	**10.03**

Notes :
1) Calculated based on survey in 44 cities and classified into 7 categories, 1996 = 100
2) Calculated based on survey in 43 cities (excl. Dili) and classified into 7 categories, 1996 = 100
Source : BPS-Statistics Indonesia

Table 17
Balance of Payments
(millions of $)

Item	1998	1999	2000	2001	2002*
A. Current Account	**4,097**	**5,783**	**7,991**	**6,901**	**7,262**
1. Merchandise	**18,429**	**20,644**	**25,042**	**22,696**	**23,147**
a. Export f.o.b	50,370	51,242	65,407	57,365	57,970
- Non-oil and gas	42,951	40,988	50,341	44,805	45,253
- Oil and gas	7,419	10,255	15,066	12,560	12,717
b. Import f.o.b	-31,942	-30,598	-40,365	-34,668	-34,823
- Non-oil and gas	-29,087	-26,631	-34,378	-28,961	-28,259
- Oil and gas	-2,855	-3,967	-5,988	-5,707	-6,564
2. Services (net)	**-14,332**	**-14,861**	**-17,051**	**-15,795**	**-15,885**
- Non-oil and gas	-11,420	-11,660	-12,500	-11,501	-11,641
- Oil and gas	-2,911	-3,201	-4,551	-4,294	-4,244
B. Capital Account	**-3,876**	**-4,571**	**-6,772**	**-8,992**	**-3,592**
1. Official capital movement (net)	**9,970**	**5,352**	**3,217**	**-741**	**-556**
a. Inflows	13,174	7,932	4,986	1,107	1,266
- Program aid	1,821	3,870	1,361	507	773
- Food aid	160	273	76	0	0
- IGGI/CGI	2,787	2,408	2,420	1,963	1,358
- Non-IGGI/CGI	8,406	1,381	1,130	-1,363	-865
b. Debt repayments [1/]	-3,204	-2,581	-1,769	-1,847	-1,823
2. Private capital movement (net)	**-13,846**	**-9,923**	**-9,989**	**-8,252**	**-3,035**
a. Direct investment (bersih)	-356	-2,745	-4,550	-5,876	-6,940
b. Others (net)	-13,490	-7,178	-5,439	-2,375	3,905
C. Total (A+B)	**221**	**1,213**	**1,219**	**-2,091**	**3,670**
D. Errors and Omissions (net)	**2,123**	**2,079**	**3,823**	**713**	**-115**
E. Monetary Movement [2/]	**-2,344**	**-3,292**	**-5,042**	**1,378**	**-3,555**

1/ Including rescheduling
2/ Minus (-) : Surplus,vice versa

Table 18
Export Value of Non-oil and gas by Commodity
(millions of $)

Item	1998	1999	2000	2001	2002*
Total Exports	**42,951**	**40,987**	**50,341**	**44,805**	**45,253**
Agriculture	**5,091**	**4,179**	**4,152**	**3,557**	**3,921**
Wood	53	86	97	105	58
Rubber	1,006	854	883	810	963
Coffee	602	465	327	161	220
Tea	169	102	115	97	114
Pepper	195	183	227	105	77
Tobacco	139	108	80	95	74
Tapioca	21	23	11	12	4
Animal and animal products	1,779	1,574	1,622	1,499	1,467
- Shrimps	1,041	886	971	864	772
Skins	72	74	94	81	68
Others	1,056	710	695	592	875
Mining	**4,703**	**4,130**	**5,566**	**5,620**	**5,370**
Tin	260	242	234	245	287
Copper	1,792	1,441	2,272	2,416	2,224
Nickel	165	219	360	299	47
Aluminum	202	138	260	212	233
Coal	1,669	1,665	1,635	1,945	2,144
Others	614	425	805	503	436
Manufacturing	**33,157**	**32,678**	**40,623**	**35,628**	**35,962**
Textiles & textile products	7,034	6,291	7,317	6,752	6,116
- Garments	3,769	3,450	4,067	3,821	3,256
Handicrafts	2,089	569	548	532	501
Wood and wood products	4,245	4,526	4,495	3,962	3,783
- Plywoods	2,328	2,259	1,996	1,725	1,515
Rattan products	39	255	296	272	280
Palm Oil	888	1,369	1,265	1,343	2,068
Copra oil-cake	51	47	62	49	64
Chemical product	2,098	1,835	2,259	2,146	2,242
Metal products	1,387	1,078	1,217	1,131	1,043
Electrical appliances	2,813	3,365	6,366	6,115	6,562
Cement	87	143	141	170	113
Paper	2,471	2,645	3,046	2,677	2,500
Rubber products	415	374	440	429	520
Glass and glassware	269	279	349	306	309
Footwear	1,583	1,519	1,620	1,433	1,349
Plastic products	935	860	1,216	1,024	1,053
Machinery and mechanical	1,478	1,853	3,783	3,054	3,128
Others	5,275	5,670	6,205	4,233	4,329

Table 19
Export Volume of Non-oil and gas by Commodity
(thousands of tons)

Descriptions	1998		1999		2000		2001		2002*	
	Volume	Share (%)	Volume	Share (%)	Volume	Share (%)	Volume	Share (%)	Volume	Share (%)
Total Exports	**199,771**	**100.0**	**175,610**	**100.0**	**172,032**	**100.0**	**226,385**	**100.0**	**195,480**	**100.0**
Agriculture	**5,936**	**3.0**	**5,395**	**3.1**	**4,467**	**2.6**	**4,579**	**2.0**	**4,220**	**2.2**
Wood	489	0.2	679	0.4	685	0.4	849	0.4	952	0.5
Rubber	1,584	0.8	1,544	0.9	1,410	0.8	1,554	0.7	1,288	0.7
Coffe	411	0.2	362	0.2	363	0.2	270	0.1	222	0.1
Tea	113	0.1	107	0.1	109	0.1	96	0.0	91	0.0
Pepper	45	0.0	35	0.0	67	0.0	54	0.0	64	0.0
Tobacco	114	0.1	78	0.0	32	0.0	46	0.0	57	0.0
Tapioca	211	0.1	300	0.2	161	0.1	173	0.1	109	0.1
Animal and animal products	949	0.5	819	0.5	664	0.4	567	0.3	649	0.3
- Shrimps	165	0.1	164	0.1	182	0.1	147	0.1	180	0.1
Skins	13	0.0	38	0.0	11	0.0	10	0.0	11	0.0
Others	2,007	1.0	1,433	0.8	965	0.6	960	0.4	777	0.4
Mining	**154,226**	**77.2**	**116,809**	**66.5**	**125,015**	**72.7**	**174,330**	**77.0**	**142,392**	**72.8**
Tin	49	0.0	47	0.0	46	0.0	70	0.0	74	0.0
Copper	2,946	1.5	2.261	1.3	3,144	1.8	3,110	1.4	3,492	1.8
Nickel	1,409	0.7	2.008	1.1	1,918	1.1	2,414	1.1	18,003	9.2
Aluminum	1,076	0.5	1.125	0.6	1,204	0.7	1,318	0.6	1,471	0.8
Coal	52,411	26.2	53,899	30.7	59,742	34.7	68,496	30.3	69,021	35.3
Others	96,335	48.2	57,469	32.7	58,961	34.3	98,922	43.7	50,331	25.7
Manufacturing	**39,609**	**19.8**	**49,307**	**28.1**	**42,550**	**24.7**	**47,476**	**21.0**	**48,868**	**25.0**
Textiles and textile products	1,635	0.8	1,525	0.9	1,677	1.0	1,685	0.7	1,950	1.0
- Garments	414	0.2	333	0.2	351	0.2	347	0.2	379	0.2
Handicraft	223	0.1	196	0.1	205	0.1	246	0.1	248	0.1
Wood and wood product	7,302	3.7	6,791	3.9	6,770	3.9	6,242	2.8	6,660	3.4
- Plywood	5,157	2.6	4,302	2.4	3,970	2.3	3,668	1.6	3,792	1.9
Rattan products	14	0.0	114	0.1	130	0.1	110	0.0	126	0.1
Palm Oil	1,700	0.9	3,600	2.0	4,521	2.6	5,728	2.5	4,153	2.1
Copra oil-cake	984	0.5	983	0.6	1,225	0.7	1,309	0.6	854	0.4
Chemical products	6,883	3.4	5,378	3.1	5,916	3.4	5,604	2.5	5,914	3.0
Metal products	3,391	1.7	3,191	1.8	1,515	0.9	1,667	0.7	2,042	1.0
Electrical appliances	381	0.2	437	0.2	692	0.4	689	0.3	753	0.4
Cement	3,736	1.9	7,383	4.2	7,292	4.2	10,190	4.5	12,268	6.3
Paper	5,585	2.8	9,048	5.2	5,048	2.9	4,626	2.0	5,560	2.8
Rubber products	203	0.1	209	0.1	279	0.2	264	0.1	246	0.1
Glass and glassware	957	0.5	1,555	0.9	960	0.6	807	0.4	1,580	0.8
Footwear	173	0.1	165	0.1	157	0.1	148	0.1	142	0.1
Plastics products	1,244	0.6	1,045	0.6	1,195	0.7	1,006	0.4	1,356	0.7
Machinery and mechanical	763	0.4	166	0.1	288	0.2	278	0.1	330	0.2
Others	4,435	2.2	7,156	4.1	4,680	2.7	6,877	3.0	4,686	2.4

Table 20
Export Value of Non-oil and gas by Country of Destination
(millions of $)

Continents/Countries	1998		1999		2000		2001		2002*	
	Value	Share (%)	Value	Share (%)	Value	Share (%)	Value	Share (%)	Value	Share (%)
Africa	**904**	**2.1**	**1,032**	**2.5**	**1,157**	**2.3**	**1,120**	**2.5**	**1,085**	**2.4**
America	**7,815**	**18.2**	**7,679**	**18.7**	**9,993**	**19.9**	**8,753**	**19.5**	**8,637**	**19.1**
United States of America	6,383	14.9	6,297	15.4	8,463	16.8	7,385	16.5	7,319	16.2
Latin America	459	1.1	429	1.0	626	1.2	557	1.2	554	1.2
Canada	409	1.0	346	0.8	446	0.9	405	0.9	369	0.8
Others	564	1.3	607	1.5	458	0.9	406	0.9	395	0.9
Asia	**24,831**	**57.8**	**23,573**	**57.5**	**28,579**	**56.8**	**25,219**	**56.3**	**25,718**	**56.8**
ASEAN	**8,723**	**20.3**	**7,982**	**19.5**	**9,748**	**19.4**	**8,555**	**19.1**	**8,811**	**19.5**
Brunei	43	0.1	26	0.1	24	0.0	29	0.1	32	0.1
Malaysia	1,358	3.2	1,388	3.4	1,861	3.7	1,706	3.8	1.887	4.2
Philippines	608	1.4	646	1.6	861	1.7	807	1.8	783	1.7
Singapore	5,798	13.5	4,998	12.2	6,073	12.1	5,058	11.3	5,123	11.3
Thailand	916	2.1	923	2.3	928	1.8	955	2.1	986	2.2
Hong Kong	2,037	4.7	1,400	3.4	1,574	3.1	1,267	2.8	1,186	2.6
India	782	1.8	807	2.0	1.088	2.2	981	2.2	1.166	2.6
Iraq	45	0.1	63	0.2	95	0.2	89	0.2	26	0.1
Japan	5,964	13.9	5,791	14.1	7,844	15.6	6,934	15.5	6,256	13.8
South Korea	1,166	2.7	1,287	3.1	1,710	3.4	1,634	3.6	1,795	4.0
Myanmar	175	0.4	101	0.2	64	0.1	66	0.1	54	0.1
Pakistan	152	0.4	151	0.4	148	0.3	182	0.4	241	0.5
People's Republic of China	1,320	3.1	1,486	3.6	1,828	3.6	1,573	3.5	2,060	4.6
Saudi Arabia	476	1.1	428	1.0	535	1.1	477	1.1	464	1.0
Taiwan	1,288	3.0	1,234	3.0	1,487	3.0	1,228	2.7	1,177	2.6
Others	2,702	6.3	2,846	6.9	2,458	4.9	2,232	5.0	2,483	5.5
Australia/Oceania	**910**	**2.1**	**1,058**	**2.6**	**1,080**	**2.1**	**1,029**	**2.3**	**1,365**	**3.0**
Europe	**8,491**	**19.8**	**7,645**	**18.7**	**9,532**	**18.9**	**8,683**	**19.4**	**8,448**	**18.7**
European Community	**7,474**	**17.4**	**6,744**	**16.5**	**8,774**	**17.4**	**7,719**	**17.2**	**7,363**	**16.3**
Netherlands	1,488	3.5	1,464	3.6	1,895	3.8	1,639	3.7	1,469	3.2
Belgium dan Luxembourg	773	1.8	687	1.7	892	1.8	730	1.6	776	1.7
United Kingdom	1,120	2.6	1,175	2.9	1.575	3.1	1.594	3.6	1,454	3.2
Italy	729	1.7	605	1.5	708	1.4	605	1.3	598	1.3
Germany	1,458	3.4	1,217	3.0	1.435	2.9	1,277	2.9	1,235	2.7
France	545	1.3	506	1.2	730	1.5	598	1.3	611	1.3
Others	1,360	3.2	1,090	2.7	1,540	3.1	1,275	2.8	1,220	2.7
Former Soviet Union	67	0.2	49	0.1	81	0.2	60	0.1	67	0.1
Other Eastern Europe	310	0.7	232	0.6	243	0.5	237	0.5	301	0.7
Others	640	1.5	621	1.5	433	0.9	667	1.5	717	1.6
T O T A L	**42,951**	**100.0**	**40,987**	**100.0**	**50,341**	**100.0**	**44,805**	**100.0**	**45,253**	**100.0**

Table 21
Import Value of Non-oil and gas by Country of Origin (FOB)
(millions of $)

Continent/Country	1998		1999		2000		2001		2002*	
	Value	Share (%)	Value	Share (%)	Value	Share (%)	Value	Share (%)	Value	Share (%)
Africa	**399**	**1.2**	**458**	**1.6**	**496**	**1.3**	**540**	**1.7**	**390**	**1.3**
America	**5,841**	**18.2**	**5,213**	**18.0**	**6,086**	**16.4**	**4,943**	**15.8**	**4,340**	**14.3**
United States of America	3,482	10.8	3,817	13.2	4,362	11.8	3,926	12.5	3,229	10.6
Latin America	462	1.4	726	2.5	722	1.9	469	1.5	557	1.8
Canada	468	1.5	601	2.1	868	2.3	486	1.6	512	1.7
Others	1,428	4.4	70	0.2	133	0.4	61	0.2	42	0.1
Asia	**15,857**	**49.3**	**15,459**	**53.3**	**20,996**	**56.6**	**17,657**	**56.4**	**17,916**	**59.0**
ASEAN	**2,646**	**8.2**	**4,194**	**14.5**	**5,077**	**13.7**	**4,675**	**14.9**	**4,693**	**15.4**
Brunei	2	0.0	2	0.0	2	0.0	2	0.0	2	0.0
Malaysia	380	1.2	679	2.3	906	2.4	882	2.8	948	3.1
Philippines	77	0.2	91	0.3	159	0.4	122	0.4	142	0.5
Singapore	1,320	4.1	2,189	7.6	2,613	7.0	2,414	7.7	2,221	7.3
Thailand	867	2.7	1,233	4.3	1,397	3.8	1,255	4.0	1,380	4.5
Hong Kong	260	0.8	349	1.2	488	1.3	326	1.0	293	1.0
India	286	0.9	403	1.4	627	1.7	638	2.0	794	2.6
Iraq	3	0.0	0	0.0	0	0.0	3	0.0	0	0.0
Japan	4,641	14.4	4,472	15.4	7,094	19.1	5,298	16.9	5,500	18.1
South Korea	1,356	4.2	1,753	6.0	2,474	6.7	2,264	7.2	1,790	5.9
Myanmar	10	0.0	26	0.1	29	0.1	26	0.1	46	0.2
Pakistan	140	0.4	125	0.4	73	0.2	89	0.3	61	0.2
People's Republic of China	981	3.1	1.712	5.9	2,414	6.5	2,086	6.7	2,600	8.6
Saudi Arab	117	0.4	203	0.7	301	0.8	264	0.8	211	0.7
Taiwan	974	3.0	1,170	4.0	1,718	4.6	1,430	4.6	1,283	4.2
Others	4,443	13.8	1,053	3.6	700	1.9	557	1.8	644	2.1
Australia/Oceania	**1,785**	**5.6**	**2,139**	**7.4**	**2,558**	**6.9**	**2,386**	**7.6**	**2,114**	**7.0**
Europe	**8,256**	**25.7**	**5,727**	**19.8**	**6,950**	**18.7**	**5,803**	**18.5**	**5,628**	**18.5**
European Community	**5,456**	**17.0**	**4,561**	**15.7**	**5,255**	**14.2**	**4,543**	**14.5**	**4,281**	**14.1**
Netherlands	349	1.1	489	1.7	611	1.6	440	1.4	446	1.5
Belgium dan Luxembourg	256	0.8	251	0.9	395	1.1	270	0.9	247	0.8
United Kingdom	861	2.7	769	2.7	934	2.5	757	2.4	526	1.7
Italy	528	1.6	362	1.3	455	1.2	522	1.7	566	1.9
Germany	2,652	8.3	1.758	6.1	1.727	4.7	1.644	5.2	1,648	5.4
France	564	1.8	513	1.8	648	1.7	517	1.6	523	1.7
Others	246	0.8	418	1.4	485	1.3	392	1.3	324	1.1
Former Soviet Union	166	0.5	188	0.6	319	0.9	210	0.7	226	0.7
Other Eastern Europe	74	0.2	64	0.2	65	0.2	57	0.2	92	0.3
Others	2,560	8	914	3.2	1,312.4	3.5	992.6	3.2	1,030	3.4
T O T A L	**32,137**	**100**	**28,997**	**100**	**37,087**	**100**	**31,328**	**100**	**30,388**	**100.0**

Table 22
Exports of Oil and Gas [1)]

Countries	1998	1999	2000	2001	2002[1)]
Export Value [2)]					
Oil and oil products	4,141	5,680	7,954	6,921	6,679
Gas					
- LNG	3,046	4,207	6,756	5,270	5,728
- LPG	233	369	356	369	310
Total	**7,420**	**10,256**	**15,066**	**12,560**	**12,717**
Export Volume					
Oil and oil products (millions of barrel)	340	336	291	297	275
Gas					
- LNG (millions of MMBTU) [3)]	1,384	1,511	1,400	1,222	1,377
- LPG (millions of Mton)	1,620	1,865	1,215	1,458	1,297

1) The f.o.b. value classification system changed into H.S (Harmonized Commodity Description and Coding System) so that groups of export items changed.
2) Consist of crude oil and oil product (in millions $)
3) MMBTU : Million British Thermal Unit

Table 23
Money Supply
(billions of rupiah)

End of period	M1[1)] Outstanding	M1 Share (%)	Quasi Money[2)] Outstanding	Quasi Money Share (%)	M2[3)] Outstanding	M2 Change (%) Annual	M2 Change (%) Quarterly
1998	**101,197**	**17.5**	**476,184**	**82.5**	**577,381**	**62.3**	**4.9**
1998/1999	**105,705**	**17.5**	**497,620**	**82.5**	**603,325**	**34.1**	**4.5**
1999 [4)]	124,633	19.3	521,572	80.7	646,205	11.9	-0.9
2000	162,186	21.7	584,842	78.3	747,028	15.6	8.8
2001							
March	148,375	19.3	618,437	80.7	766,812	16.8	2.6
June	160,142	20.1	636,298	79.9	796,440	16.4	3.9
September	164,237	21.0	618,867	79.0	783,104	14.1	-1.7
December	177,731	21.1	666,323	78.9	844,053	13.0	7.8
2002							
January	166,769	19.9	671,253	80.1	838,022	13.4	
February	168,643	20.1	668,517	79.9	837,160	10.8	
March	166,173	20.0	665,238	80.0	831,411	8.4	-1.5
April	169,002	20.4	659,276	79.6	828,278	4.6	
May	168,257	20.2	664,827	79.8	833,084	5.7	
June	174,017	20.8	664,618	79.2	838,635	5.3	0.9
July	173,524	20.3	679,194	79.7	852,718	10.6	
August	175,966	20.5	680,869	79.5	856,835	10.7	
September	181,791	21.1	677,915	78.9	859,706	9.8	2.5
October	181,667	21.1	681,343	78.9	863,010	6.7	
November	196,537	22.6	673,509	77.4	870,046	5.9	
December	191,939	21.7	691,969	78.3	883,908	4.7	2.8

1) Consists of currency and demand deposits.
2) Consists of time and saving deposits in rupiah and foreign currency, and demand deposits in foreign currency held by residents.
3) Consists of narrow money (M1) and quasi money
4) excluding frozen banks data (7 banks since April 1998, 3 banks since August 1998, and 38 banks since March 1999)

Table 24
Changes in Money Supply and its Affecting Factors
(billions of rupiah)

Item	1998	1999	2000	2001	2002	2002 I	2002 II	2002 III	2002 IV
Money Supply									
M2	221,738	68,824	100,823	97,026	39,854	-12,642	7,224	21,071	24,202
M1	22,854	23,436	37,553	15,545	14,208	-11,558	7,844	7,774	10,148
Currency	12,970	16,959	14,018	3,971	4,344	-6,626	2,259	782	7,929
Demand deposits	9,884	6,477	23,535	11,574	9,864	-4,932	5,585	6,992	2,219
Quasi money [1)]	198,884	45,388	63,270	81,481	25,646	-1,085	-620	13,297	14,054
Affecting factors :									
Net foreign assets	73,692	-12,581	81,637	23,242	16,721	-12,740	-14,875	32,500	11,836
Net claims on central government	17,513	425,287	123,060	9,389	-19,355	14,950	-4,954	-10,052	-19,300
Net claims on IBRA	29,693	-29,693	-	-	-	-	-	-	-
Claims on business sector	99,42	-299,689	42,347	34,233	60,143	-5,614	9,567	30,547	25,643
Claims on official entities/ state enterprises	6,389	-8,139	-4,505	3,910	4,689	-1,521	3,485	1,987	738
Claims on private enterprises and individuals	93,032	-291,550	46,852	30,323	55,454	-4,093	6,082	28,560	24,905
Net other items	1,419	-14,500	-146,221	30,162	-17,655	-9,238	17,487	-31,924	6,023

1) Consists of time and saving deposits in rupiah and foreign currency, and demand deposits in foreign currency held by residents.

Table 25
Interest Rates on Time Deposits by Denomination and Group of Banks[1)]
(percent per annum)

Maturity	December 1998		December 1999		December 2000		December 2001		December 2002	
	Rupiah	Foreign Currency	Rupiah	Foreign Currency	Rupiah	Foreign Currency	Rupiah	Foreign Currency	Rupiah	Foreign Currency
State banks										
1 - month	41.24	13.23	12.52	5.44	12.05	6.37	16.59	4.95	12.84	2.63
3 - month	48.69	13.70	13.19	5.45	13.33	6.59	17.47	5.36	13.65	2.73
6 - month	35.17	8.14	14.44	7.94	13.42	6.17	16.55	5.67	13.86	2.71
12 - month	28.75	12.61	23.14	8.91	12.48	6.24	15.81	5.95	15.67	3.32
24 - month	16.01	14.87	18.53	14.87	14.32	10.23	18.06	6.34	18.05	5.57
Private national banks										
1 - month	41.88	12.72	12.14	5.34	12.05	6.07	15.83	4.05	12.90	2.32
3 - month	50.24	10.64	12.66	5.68	13.20	6.43	16.94	4.90	13.77	2.67
6 - month	33.34	10.21	13.55	7.98	13.16	6.23	15.58	5.32	13.91	2.73
12 - month	26.16	11.49	17.07	16.63	11.50	11.39	14.74	5.70	14.73	3.25
24 - month	22.85	14.91	17.59	8.02	14.22	8.14	17.22	6.27	17.18	6.23
Regional government banks										
1 - month	42.05	12.99	12.20	5.09	11.39	4.97	15.04	5.05	12.81	2.48
3 - month	45.35	10.99	12.51	6.19	12.92	4.56	15.98	4.71	13.56	2.65
6 - month	29.46	10.43	13.46	5.18	12.94	5.13	15.61	5.48	14.14	4.17
12 - month	23.91	12.94	16.17	5.67	11.43	5.05	14.99	5.37	14.44	3.50
24 - month	14.03	...	13.73	...	13.44	...	17.42	...	17.72	...
Foreign banks and joint banks										
1 - month	33.07	4.71	9.46	4.08	9.73	4.61	12.96	1.92	10.50	1.86
3 - month	40.84	4.71	9.24	4.03	11.21	4.81	12.35	2.00	9.89	1.92
6 - month	44.42	5.15	9.05	4.31	8.13	4.12	11.63	2.58	9.66	2.39
12 - month	31.74	5.17	13.46	4.67	8.51	5.09	12.99	3.40	11.68	2.40
24 - month	15.57	3.59	11.67	4.00	13.00	6.05	8.72	2.53	15.97	3.21
Commercial banks										
1 - month	41.42	12.11	12.24	5.15	11.96	5.94	16.07	4.18	12.81	2.44
3 - month	49.23	10.73	12.95	5.24	13.24	6.11	17.24	4.35	13.63	2.65
6 - month	36.78	8.22	14.25	7.85	13.31	5.72	16.18	5.12	13.79	2.70
12 - month	28.29	11.66	22.35	9.11	12.17	7.86	15.48	5.62	15.28	3.24
24 - month	16.61	14.71	18.38	14.63	14.32	9.47	18.05	6.32	18.02	5.28

1) Weighted average at the end of period

Table 26
Inter-bank Money Market in Jakarta

End of period		Value of transaction (billions of rupiah)	Weighted average interest rate (percent per annum)
1998	January - December	13,624	63.14
1999	January- December	4,411	23.79
2000	January - December	2,272	10.46
2001	January - December	3,194	14.56
1998	January - March	14,09	57.36
	April - June	15,148	66.38
	July - September	15,884	74.13
	October - December	9,154	54.68
1999	January - March	5,165	39.57
	April - June	5,254	29.70
	July - September	3,393	13.44
	October - December	3,831	12.43
2000	January - March	1,806	9.50
	April - June	1,916	10.03
	July - September	2,488	10.89
	October - December	2,877	11.43
2001	January - March	3,071	12.71
	April - June	3,106	14.45
	July - September	3,335	15.15
	October - December	3,264	15.93
2002 1)	January	3,168	15.67
	February	4,234	17.18
	March	3,816	15.70
	January - March	3,739	**16.18**
	April	3,825	15.69
	May	3,838	15.05
	June	3,969	14.83
	April - June	3,878	**15.19**
	July	3,437	14.51
	August	3,921	13.73
	September	4,060	12.43
	July - September	3,806	**13.56**
	October	4,005	12.80
	November	3,386	11.46
	December	3,332	11.31
	October - December	3,574	**11.86**

1) Daily average figures

Table 27
Discount Rates on Rupiah Certificate of Deposits by Group of Banks [1)]
(percent per annum)

Maturity	1999	2000	2001				2002			
	December	December	March	June	September	December	March	June	September	December
State banks										
1 - month	37.96	12.04	13.26	15.33	16.22	16.48	16.19	13.99	13.29	12.91
3 - month	36.94	12.95	13.05	14.99	16.26	17.51	17.19	16.58	14.34	13.26
6 - month	28.13	11.62	11.36	14.84	15.15	14.25	17.49	17.12	15.30	15.06
12 - month	23.60	11.66	12.04	14.89	15.88	16.03	16.18	16.16	15.81	14.72
24 - month	14.22	11.50	13.70	16.30	16.28	16.28	16.29	16.33	16.83	15.05
Private national banks										
1 - month	38.77	12.59	14.20	14.50	16.76	17.28	17.11	15.85	14.52	13.76
3 - month	39.53	11.81	12.93	14.35	15.49	16.81	17.07	16.28	15.25	13.75
6 - month	32.62	13.24	14.16	14.81	15.34	15.77	16.69	17.01	16.08	15.24
12 - month	52.40	12.12	12.73	12.81	17.19	17.62	17.44	17.45	13.97	14.65
24 - month	30.00	-	-	-	-	-	-	-	-	-
Regional development banks										
1 - month	31.90	11.26	11.98	13.95	14.69	15.85	16.38	14.98	14.00	12.16
3 - month	35.48	13.88	15.62	15.78	17.24	18.19	18.09	16.92	15.03	14.23
6 - month	26.26	12.00	12.00	12.49	12.50	-	-	-	15.00	15.00
12 - month	25.21	13.81	13.83	14.60	14.54	13.00	15.46	15.92	14.77	15.68
24 - month	14.50	-	-	-	-	-	-	-	-	-
Foreign banks and joint banks										
1 - month	48.41	9.43	10.05	10.63	10.93	11.90	-	-	-	-
3 - month	34.00	9.70	10.06	11.43	12.43	13.78	-	-	-	-
6 - month	35.50	8.28	8.64	8.70	9.00	10.24	-	-	-	-
12 - month	-	7.90	8.20	8.33	8.38	8.40	-	-	-	-
24 - month	-	-	-	-	-	-	-	-	-	-
Commercial banks										
1 - month	39.57	12.47	14.09	14.60	16.55	16.81	16.75	15.73	14.45	13.57
3 - month	38.68	11.83	12.89	14.40	15.58	16.97	17.12	16.41	14.99	13.67
6 - month	30.89	12.00	12.00	14.81	15.18	14.65	17.39	17.09	15.39	15.07
12 - month	28.77	12.11	12.65	13.97	16.39	16.50	16.52	16.49	15.68	14.72
24 - month	14.53	11.50	13.70	16.30	16.28	16.28	16.29	16.33	16.33	15.05

1) Weighted average at the end of period

Table 28
Issuance, Repayment, and Outstanding of Bank Indonesia Certificates (SBIs)
(billions of rupiah)

End of periode	Issuance	Repayment	Outstanding[1)]
January - December 1998	735,844	700,182	42,765
January - December 1999	711,542	691,408	62,899
January - December 2000	928,944	937,212	59,781
January - December 2001	970,380	974,669	900,128
2002			
January	115,374	66,731	104,385
February	95,005	95,621	103,769
March	84,089	87,670	100,188
April	84,146	89,451	94,883
May	100,496	93,673	101,706
June	83,004	82,129	102,581
July	81,778	84,520	99,839
August	97,668	98,751	98,756
September	73,122	74,101	97,777
October	93,556	97,423	93,910
November	63,425	71,617	85,718
December	53,157	60,000	78,484

Note :
SBI was introduced in February 1984. Since July 1988, the selling of SBIs was executed by Stop Out Rate (SOR) system auction
1) Daily average

Table 29
Discount Rates on Bank Indonesia Certificates (SBIs)[1)]
(percent per annum)

Period	7-day	14-day	28-day	90-day	180-day	360-day
1998						
March	29.24	-	27.75	-	-	-
June	-	52.81	58.00	-	-	-
September	-	-	68.76	-	-	-
December	-	-	38.44	39.00	-	-
1999						
March	-	-	37.84	38.00	-	-
June	-	-	22.05	23.75	-	-
September	-	-	13.02	13.25	-	-
December	-	-	12.51	12.75	-	-
2000	-	-	11.03	11.00	-	-
March	-	-	11.74	11.09	-	-
June	-	-	13.62	13.32	-	-
September	-	-	14.53	14.31	-	-
December						
2001						
March			15.16	14.94		
June			16.52	16.28		
September			17.65	17.56		
December			17.62	17.63		
2002						
January	-	-	17.09	17.43	-	-
February	-	-	16.86	17.01	-	-
March	-	-	16.76	16.89	-	-
April	-	-	16.61	16.75	-	-
May	-	-	15.51	16.29	-	-
June	-	-	15.11	15.18	-	-
July	-	-	14.93	15.00	-	-
August	-	-	14.35	14.93	-	-
September	-	-	13.22	14.11	-	-
October	-	-	13.10	13.12	-	-
November	-	-	13.06	13.12	-	-
December	-	-	13.02	13.12	-	-

1) Weighted average

Table 30
Money Market Securities (SBPUs) Transactions between Bank Indonesia and Banks
(billions of rupiah)

Period	Buying	Repayment	Outstanding
1998			
January - March	257,109	256,474	4,090
April - June	42,929	46,873	146
July - September	24,136	24,057	227
October - December	1,342	550	1,018
1999			
January - March	1,018	1,018	1,018
April - June	0	0	1,018
July - September	0	0	1,018
October - December	644	1,662	0
2000			
January - March	0	0	0
April - June	0	0	0
July - September	0	0	0
October - December	0	0	0
2001			
January - March	112	112	0
April - June	22	22	0
July - September	0	0	0
October - December	8	8	0
2002			
January	0	0	0
February	0	0	0
Marh	0	0	0
April	0	0	0
May	0	0	0
June	0	0	0
July	0	0	0
August	0	0	0
September	0	0	0
October	0	0	0
November	0	0	0
December	0	0	0

Table 31
Government Revenues & Expenditures
(billions of rupiah)

Items	1998/99[1)]	1999/00[1)]	2000 [1)]	2001 [1)]	2002 Budget[2)]	2002 Realization[3)]	2003 Budget[2)]
Government Revenues and Grants	**156,470**	**187,819**	**205,334**	**301,078**	**301,874**	**300,188**	**336,156**
Domestic revenues	**156,409**	**187,819**	**205,334**	**300,600**	**301,874**	**299,887**	**336,156**
Tax Revenues 102,395	**125,951**	**115,912**	**185,541**	**219,627**	**210,954**	**254,140**	
Domestic taxes	**95,459**	**120,915**	**108,884**	**175,974**	**207,029**	**200,325**	**241,742**
Income tax (PPh)	55,944	72,729	57,073	94,576	104,497	101,675	120,925
Non-oil and gas	55,944	59,683	38,421	71,474	88,815	84,460	106,149
Oil and gas	-	13,046	18,652	23,102	15,682	17,215	14,776
Value added tax (PPN)	27,803	33,087	35,232	55,957	70,100	65,853	80,790
Land and building tax (PBB)	3,504	3,525	5,246	5,924	6,357	7,524	
Duties on land and building transfer	523	604	931	1,417	2,205	1,629	2,402
Excise duties	7,733	10,381	11,287	17,394	22,353	23,341	27,946
Other taxes	413	611	837	1,384	1,950	1,470	2,157
International trade taxes	**6,936**	**5,036**	**7,028**	**9,567**	**12,599**	**10,629**	**12,398**
Import duties	2,306	4,177	6,697	9,026	12,249	10,399	11,960
Export tax	4,630	859	331	541	350	230	438
Non-tax revenues	**54,014**	**61,868**	**89,422**	**115,059**	**82,247**	**88,933**	**82,015**
Natural Resource Revenues	41,368	45,435	76,290	85,672	63,195	65,222	59,396
Oil	25,957	-	50,953	58,950	44,013	47,689	39,911
Gas	15,411	-	15,708	22,091	14,524	12,325	16,285
Other natural resources 5	-	-	9,629	4,631	4,658	5,208	3,201
Mining	-	-	857	2,320	1,340	1,850	1,483
Forestry	-	-	8,719	2,243	3,026	3,155	1,268
Fishery	-	-	53	68	292	203	450
Profit transfer from SOEs	3,428	5,430	4,018	8,837	10,351	9,760	10,414
Other non-tax revenues (PNBP)	9,217	11,002	9,114	20,550	8,700	13,951	12,206
Grants	**62**	**-**	**-**	**478**	**-**	**301**	**-**
Government Expenditures	**172,669**	**231,879**	**221,467**	**341,563**	**344,009**	**327,863**	**370,591**
Central government expenditures	**146,020**	**201,943**	**188,392**	**260,508**	**246,040**	**229,341**	**253,714**
Routine expenditures	**103,261**	**156,756**	**162,577**	**218,923**	**193,741**	**189,069**	**188,584**
Personnel expenditures	**23,216**	**32,719**	**29,613**	**38,713**	**41,298**	**39,687**	**50,240**
Salaries and pensions	18,657	27,010	25,005		34,003		41,437
Rice allowances	1,245	1,822	1,521		1,412		1,575
Food allowances	1,547	2,567	2,606		2,832		3,460
Other domestic personnel expenditures	1,073	1,294	443		1,550		2,230
Overseas personnel expenditures	695	25	38		1,502		1,539
Material expenditures	**9,862**	**10,765**	**9,605**	**9,931**	**12,863**	**12,433**	**15,427**
Domestic	8,888	9,784	9,500		11,707		14,236
Overseas	974	980	104		1,156		1,191
Interest payment	**32,864**	**42,910**	**50,068**	**87,142**	**88,500**	**89,868**	**81,975**
Domestic debt	8,385	22,230	31,238	58,197	59,525	64,461	55,180
Foreign debt	24,480	20,679	18,830	28,945	28,975	25,406	26,795
Subsidies	**34,614**	**65,916**	**62,745**	**77,443**	**41,586**	**40,006**	**25,465**
Fuel	28,607	40,923	53,810	68,381	30,377	31,162	13,210
Non-fuel	6,008	24,993	8,936	9,063	11,209	8,845	12,255
Other routine expenditures	**2,703**	**4,446**	**10,546**	**5,694**	**9,494**	**7,076**	**15,476**
Development expenditures	**42,759**	**45,187**	**25,815**	**41,585**	**52,299**	**40,271**	**65,130**
Rupiah financing	16,578	20,804	8,845	21,371	26,469	27,639	46,230
Project aid	26,181	24,383	16,970	20,214	25,830	12,632	18,900
Regional expenditures	**26,650**	**29,936**	**33,075**	**81,054**	**97,969**	**98,522**	**116,878**
Regional balancing funds	**26,650**	**29,936**	**33,075**	**81,054**	**94,532**	**94,763**	**107,491**
Revenue sharing	3,703	3,993	4,268	20,008	24,600	24,992	27,896
General allocation funds [4)]	22,947	25,943	28,807	60,346	69,114	69,135	76,978
Special allocation funds	-	-	-	701	817	636	2,617
Special autonomy and equalization funds	**-**	**-**	**-**	**-**	**3,437**	**3,759**	**9,387**

1) Audited State Budget (PAN) figures
2) State Budget approved
3) Realization, January 1, 2002 up to December 31 (unaudited)
4) up to year 2000, consists of regional routine and development funds
Source : Ministry of Finance

Table 32
Budget Deficit Financing
(billions of rupiah)

Items	1998/99 [1]	1999/00 [1]	2000 [1]	2001 [1]	2002 Budget [2]	2002 Realization [3]	2003 Budget [2]
I. Domestic financing	**-4,799**	**14,672**	**5,937**	**30,218**	**23,501**	**20,561**	**22,450**
1. Domestic banks (SILPA/SIKPA) [4]	-6,433	-1,941	-12,964	-1,227	-	-4,713	8,500
2. Non-domestic banks	1,634	16,613	18,900	31,445	23,501	25,274	13,950
a. Privatization	1,634	3,727	-	3,465	3,952	7,665	8,000
b. Asset recovery	-	12,886	18,900	27,980	19,549	19,549	18,000
c. Domestic bonds, net	-	-	-	0	-	-1,939	-12,050
i. Government bonds	-	-	-	0	3,931	1,991	7,700
ii. Domestic debt/bond amortization	-	-	-	-	-3,931	-3,931	-19,750
II. Foreign financing, net	**20,998**	**29,388**	**10,196**	**10,267**	**18,630**	**7,116**	**11,986**
1. Gross drawing	51,045	49,584	17,818	26,152	35,360	19,374	29,250
Program loan	24,926	25,201	849	6,416	9,530	7,042	10,350
Project loan	26,119	24,383	16,970	19,736	25,830	12,332	18,900
2. Amortization	-30,047	-20,196	-7,623	-15,885	-16,730	-12,259	-17,264
Net financing	**16,199**	**44,060**	**16,132**	**40,485**	**42,131**	**29,162**	**34,436**

1) Audited State Budget (PAN) figures
2) State budget (approved)
3) Realization, January 1, 2002 up to December 31, 2002
4) Budget financing excess (SILPA)/Budget financing shortage(SIKPA)
Source : Ministry of Finance

Table 33
Funds Mobilization by Commercial Banks [1)]
(billions of rupiah)

End of period	Demand deposits			Time deposits			Saving deposits	Total
	Rupiah	Foreign Currency	Sub-total	Rupiah[2]	Foreign Currency	Sub-total		
1998	58,067	39,351	97,418	303,016	103,782	406,798	69,308	573,524
1998/1999	60,002	47,244	107,246	303,022	109,778	412,800	79,453	599,499
1999	68,456	47,110	115,566	301,431	85,640	387,071	122,981	625,618
2000	104,539	70,969	175,508	296,885	93,658	390,543	154,328	720,379
2001								
March	102,113	64,116	166,228	321,209	99,132	420,340	153,385	739,953
June	107,089	68,126	175,214	315,199	111,614	426,814	160,826	762,854
September	109,021	56,781	165,802	323,337	92,225	415,562	163,278	744,642
December	123,840	66,478	190,318	348,257	97,940	446,196	172,613	809,127
2002								
January	114,802	66,363	181,165	357,143	96,687	453,830	167,888	802,883
February	115,750	65,139	180,888	355,693	96,706	452,399	166,387	799,675
March	113,974	63,419	177,393	358,238	94,198	452,436	165,022	794,851
April	117,676	63,329	181,004	357,400	89,547	446,947	166,227	794,178
May	115,753	58,554	174,307	360,883	90,242	451,125	166,992	792,424
June	119,612	60,044	179,657	362,710	82,686	445,395	171,507	796,559
July	119,958	67,033	186,991	364,857	85,873	450,730	174,299	812,019
August	120,498	63,362	183,860	371,503	87,820	459,323	172,205	815,388
September	125,567	69,470	195,037	368,091	86,441	454,532	174,814	824,384
October	125,866	73,988	199,854	366,324	86,436	452,760	178,503	831,117
November	127,769	74,226	201,995	361,057	81,450	442,507	180,767	825,269
December	130,877	73,189	204,067	365,771	81,710	447,480	193,468	845,015

1) Including deposits owned by the Central Government and nonresident
2) Including certificates of deposits

Table 34
Commercial Banks' Demand Deposits in Rupiah and Foreign Currency by Group of Banks
(billions of rupiah)

End of period	State banks			Private national banks			Regional development banks			Foreign banks & joint banks			T o t a l		
	Rupiah	Foreign currency	Sub-total	Rupiah	Foreign currency	Sub-total	Rupiah	Foreign currency	Sub-total	Rupiah	Foreign currency	Sub-total	Rupiah	Foreign currency	Sub-total
1998	24,751	8,476	33,227	23,151	13,447	36,598	4,895	13	4,908	5,270	17,415	22,685	58,067	39,351	97,418
1998/1999	28,271	11,624	39,895	21,921	14,255	36,176	4,374	12	4,386	5,436	21,353	26,789	60,002	47,244	107,246
1999	25,407	12,483	37,890	26,866	15,792	42,658	7,055	15	7,070	9,128	18,820	27,948	68,456	47,110	115,566
2000	49,205	24,284	73,489	34,123	18,973	53,096	10,806	17	10,823	10,405	27,695	38,100	104,539	70,969	175,508
2001															
March	43,822	12,893	56,715	34,133	20,914	55,048	15,083	23	15,106	9,074	30,286	39,360	102,113	64,116	166,229
June	44,526	12,442	56,968	34,728	25,398	60,126	19,539	15	19,554	8,296	30,269	38,565	107,088	68,125	175,213
September	45,145	10,539	55,684	34,546	20,872	55,418	20,810	15	20,825	8,520	25,355	33,875	109,021	56,781	165,802
December	54,256	14,430	68,686	38,099	24,270	62,369	22,775	21	22,797	8,710	27,756	36,466	123,840	66,478	190,318
2002															
January	48,288	14,010	62,298	36,938	24,370	61,308	21,342	29	21,371	8,234	27,954	36,188	114,802	66,363	181,165
February	49,514	12,580	62,093	35,567	24,877	60,444	22,483	28	22,511	8,186	27,654	35,840	115,750	65,139	180,888
March	47,801	12,807	60,608	34,332	24,026	58,358	23,647	25	23,672	8,194	26,561	34,755	113,974	63,419	177,393
April	49,120	14,467	63,587	35,651	23,933	59,585	24,273	27	24,299	8,632	24,902	33,533	117,676	63,329	181,004
May	47,475	12,808	60,283	33,651	22,508	56,160	26,842	27	26,870	7,784	23,211	30,995	115,753	58,554	174,307
June	49,322	12,964	62,286	34,952	23,872	58,823	27,260	24	27,284	8,080	23,184	31,264	119,612	60,044	179,657
July	45,746	13,392	59,138	37,449	25,393	62,841	27,347	30	27,377	9,416	28,218	37,634	119,958	67,033	186,991
August	45,463	13,844	59,307	37,177	24,865	62,042	28,674	27	28,701	9,184	24,626	33,810	120,498	63,362	183,860
September	48,067	21,328	69,396	39,622	23,651	63,273	28,848	31	28,879	9,030	24,460	33,490	125,567	69,470	195,037
October	49,411	24,463	73,875	40,111	23,890	64,001	27,435	34	27,468	8,909	25,601	34,510	125,866	73,988	199,854
November	51,304	24,068	75,372	40,841	23,676	64,516	25,579	34	25,614	10,045	26,448	36,493	127,769	74,226	201,995
December	51,320	22,413	73,733	44,238	24,922	69,160	25,758	23	25,781	9,561	25,831	35,392	130,877	73,189	204,067

Table 35
Commercial Banks' Time Deposits in Rupiah and Foreign Currency by Maturity
(billions of rupiah)

End of period		24-month	12-month	6-month	3-month	1-month[1)]	Others	Total
1998		610	21,039	17,151	50,352	266,585	51,061	406,798
1998/1999		502	15,449	19,414	24,840	307,610	44,984	412,799
1999		436	14,742	35,244	42,125	243,645	50,879	387,071
2000		14,061	6,920	23,503	68,877	215,532	61,649	390,542
2001								
	March	14,038	7,767	23,174	75,696	236,772	62,894	420,340
	June	14,395	9,451	23,644	66,928	249,025	63,371	426,814
	September	14,847	10,553	20,258	75,042	231,910	62,953	415,562
	December	18,882	13,533	17,903	77,768	242,685	75,425	446,196
2002								
	January	19,099	14,126	18,396	84,858	248,073	69,279	453,830
	February	18,784	15,834	17,065	84,759	256,853	59,104	452,399
	March	20,509	17,506	16,292	84,209	240,515	73,405	452,436
	April	21,118	19,407	15,439	79,286	245,535	66,162	446,947
	May	21,469	20,009	16,426	80,742	246,039	66,439	451,125
	June	21,625	21,108	19,071	78,357	240,985	64,250	445,395
	July	20,918	20,760	20,230	77,512	245,492	65,818	450,730
	August	21,973	22,180	20,347	74,992	246,882	72,949	459,323
	September	21,275	22,740	21,277	73,443	250,739	65,059	454,532
	October	21,399	22,322	21,187	72,427	247,573	67,851	452,760
	November	21,411	22,337	20,992	76,459	239,382	61,926	442,507
	December	21,447	23,161	20,131	77,078	248,834	56,830	447,480

1) Including matured time deposits

Table 36
Commercial Bank' Time Deposits in Rupiah by Ownership
(billions of rupiah)

End of period	Residents										Non-residents	Total
	Govern-ment	Official entities	Insurance companies	State enterprises	Private enterprises	Social institutions	Coopera-tives	Indivi-duals	Others	Sub-total		
1998	8,805	3,626	8,399	18,241	46,408	20,041	768	182,561	13,555	302,404	612	303,016
1998/1999	8,150	3,320	7,963	16,755	47,583	17,970	726	188,258	11,487	302,212	810	303,022
1999	11,268	4,713	11,916	20,463	46,883	20,188	953	173,785	10,165	300,334	1,097	301,431
2000	4,408	5,162	24,412	18,595	39,653	22,864	941	172,917	6,274	295,226	1,659	296,885
2001												
March	6,343	5,320	26,722	21,707	40,385	26,143	2,244	187,611	3,758	320,233	975	321,209
June	6,559	6,017	25,154	16,746	40,117	30,118	1,755	184,916	2,575	313,958	1,243	315,200
September	7,622	5,783	23,028	14,275	39,665	28,616	1,715	198,439	2,769	321,914	1,424	323,338
December	7,729	8,761	23,547	13,331	50,718	28,255	893	208,994	2,586	344,812	3,444	348,257
2002												
January	8,561	7,954	24,264	14,761	52,882	28,871	1,014	213,896	2,888	355,090	2,053	357,143
February	9,228	7,404	23,846	15,305	52,107	29,295	858	213,373	2,364	353,780	1,913	355,693
March	8,721	8,520	24,531	17,444	50,670	29,634	965	212,536	2,526	355,547	2,690	358,238
April	9,135	7,329	24,522	16,464	50,880	29,575	1,052	213,427	2,293	354,676	2,724	357,400
May	9,779	8,535	24,446	15,498	53,748	30,352	1,046	212,179	2,886	358,469	2,414	360,883
June	10,879	9,617	24,519	15,687	53,550	31,206	967	211,798	2,157	360,380	2,330	362,710
July	10,765	8,547	24,297	17,577	54,920	30,833	789	211,722	3,195	362,645	2,212	364,857
August	11,304	15,239	26,024	15,864	54,554	30,526	1,252	212,022	2,287	369,072	2,431	371,503
September	11,102	10,747	26,746	17,299	54,181	30,845	1,204	211,397	2,113	365,635	2,456	368,091
October	10,956	9,799	26,793	15,263	55,645	30,754	1,172	210,920	2,443	363,744	2,580	366,324
November	10,571	10,254	26,997	13,236	51,647	30,713	1,125	211,676	2,194	358,414	2,644	361,057
December	7,869	8,998	27,469	14,434	54,461	31,126	1,204	215,591	2,094	363,248	2,523	365,771

Table 37
Certificate of Deposits
(billions of rupiah)

End of period	State banks	Non-State banks	T o t al
1998	1,792	5,004	6,796
1998/1999	829	2,825	3,654
1999	491	2,156	2,647
2000	410	3,215	3,625
2001			
March	441	3,297	3,739
June	1,574	4,001	5,575
September	1,945	3,855	5,799
December	2,719	2,882	5,601
2002			
January	3,266	2,796	6,062
February	3,151	2,526	5,678
March	3,322	2,549	5,871
April	2,986	2,403	5,389
May	2,626	2,275	4,901
June	2,067	1,826	3,894
July	2,383	1,636	4,020
August	2,063	1,541	3,604
September	1,960	1,574	3,534
October	2,047	1,375	3,422
November	1,786	1,362	3,148
December	1,768	1,397	3,165

Table 38
Commercial Banks' Saving Deposits by Type of Deposits

End of period	Saving deposits withdrawnable anytime		Saving deposits		Other saving deposits		Total	
	Depositors (thousands)	Outstanding (billions of Rp)	Depositors (thousands)	Outstanding (billions of Rp)	Depositors (thousands)	Outstanding (billions of Rp)	Depositors (thousands)	Outstanding (billions of Rp)
1998	46,292	62,506	307	1,908	18,890	4,894	65,489	69,308
1998/1999	45,442	72,328	222	2,047	18,549	5,078	64,213	79,453
1999	66,926	115,945	161	855	17,437	6,181	84,524	122,981
2000	65,041	152,388	355	755	1,298	1,185	66,694	154,328
2001								
March	86,571	151,593	564	984	626	806	87,761	153,383
June	67,422	157,535	787	1,960	650	1,330	68,859	160,825
September	67,007	161,323	963	1,022	752	933	68,722	163,278
December	68,138	170,783	510	995	823	834	69,470	172,613
2002								
January	67,752	165,930	490	767	858	1,190	69,100	167,888
February	68,020	164,460	513	918	852	1,008	69,385	166,387
March	68,247	163,003	445	949	985	1,070	69,677	165,022
April	68,062	164,072	629	1,224	845	931	69,535	166,227
May	69,120	164,564	562	1,491	1020	937	70,702	166,992
June	69,333	168,475	519	1,916	1229	1,116	71,081	171,507
July	68,733	170,457	722	2,643	1184	1,199	70,639	174,299
August	69,381	170,139	777	1,077	1235	989	71,394	172,205
September	69,804	172,856	559	933	1232	1,025	71,595	174,814
October	69,771	176,441	692	1,066	1120	996	71,583	178,503
November	69,132	178,861	605	893	1068	1,013	70,805	180,767
December	68,010	191,177	750	1,116	1028	1,175	69,789	193,468

Table 39
Interest Rates on Rupiah Credits by Group of Banks [1)]
(percent)

End of period	State Banks		Regional Development Banks		Private National Banks		Foreign Banks & Joint Banks		Commercial Banks	
	Working Capital	Invesment	Working Capital	Invesment	Working Capital	Invesment	Working Capital	Invesment	Working Capital	Invesment
1998	29.03	22.35	30.20	15.83	38.70	40.32	42.89	35.53	34.75	26.23
1999	21.61	17.48	21.81	13.43	19.57	20.61	18.28	22.70	20.68	17.80
2000	18.40	16.53	21.11	18.11	17.55	17.59	15.42	15.49	17.65	16.86
2001										
March	18.47	16.31	20.87	18.02	17.84	17.95	16.28	16.30	17.90	16.86
June	18.64	16.41	20.84	18.07	18.28	17.94	18.05	16.69	18.45	17.04
September	18.91	16.44	20.84	17.73	18.96	18.22	19.24	17.98	19.06	17.22
December	19.15	17.11	20.48	17.76	19.16	19.02	19.09	18.55	19.19	17.90
2002										
January	19.08	17.22	20.46	17.76	19.45	19.12	18.98	18.54	19.27	17.99
February	19.05	17.24	20.42	17.72	19.48	19.15	19.34	18.36	19.33	18.01
March	18.99	17.31	20.49	17.68	19.51	19.11	19.43	18.31	19.35	18.03
April	18.99	17.39	20.34	17.67	19.54	19.12	18.62	18.70	19.25	18.09
May	19.02	17.41	20.38	17.75	19.38	19.08	18.76	18.33	19.20	18.11
June	19.12	17.47	20.29	17.84	19.25	19.00	17.89	18.16	19.08	18.11
July	19.07	17.50	20.28	17.82	19.09	18.94	17.97	17.73	19.00	18.09
August	19.02	17.59	20.25	17.79	18.95	18.88	17.58	17.69	18.86	18.10
September	19.01	17.72	20.21	17.73	18.80	18.73	17.06	17.30	18.74	18.11
October	18.97	17.65	20.13	17.71	18.66	18.52	16.20	17.03	18.57	18.00
November	18.98	17.66	20.04	17.77	18.46	18.49	15.99	17.05	18.44	18.00
December	18.85	17.50	19.93	17.89	18.21	18.30	15.71	16.09	18.25	17.82

1) Weighted average

Tabel 40
Commercial Banks' Credits in Rupiah and Foreign Currency by Economic Sector[1)]
(billions of rupiah)

Description	1998	1999	2000	2001	2002 Mar.	2002 Jun.	2002 Sep.	2002 Dec.
Credit in rupiah	**313,118**	**140,527**	**152,482**	**202,618**	**204,639**	**224,864**	**250,162**	**271,851**
Agriculture	29,430	21,139	15,028	16,851	17,226	18,844	19,279	19,121
Mining	2,729	879	2,879	890	3,990	1,694	1,559	2,441
Manufacturing	85,594	35,561	35,697	50,434	48,338	48,852	57,218	64,986
Trade	59,830	29,687	30,601	38,491	38,782	46,968	53,240	56,854
Services	101,129	26,332	23,784	30,696	31,189	34,970	40,780	44,581
Others	34,406	26,929	44,493	65,256	65,114	73,536	78,086	83,868
Credit in foreign currency	**174,308**	**84,606**	**116,518**	**104,977**	**98,137**	**87,154**	**91,010**	**95,559**
Agriculture	9,878	2,638	4,475	4,012	3,964	3,653	3,940	3,211
Mining	3,180	2,818	3,801	3,764	3,191	2,629	3,021	3,654
Manufacturing	86,074	48,698	71,085	66,091	61,612	54,878	55,470	58,049
Trade	36,534	13,601	13,498	9,959	9,247	8,214	8,635	9,124
Services	37,995	16,829	20,532	18,365	17,714	16,153	18,323	16,402
Others	647	22	3,127	2,785	2,409	1,627	1,621	5,119
Total	**487,426**	**225,133**	**269,000**	**307,594**	**302,776**	**312,018**	**341,172**	**365,410**
Agriculture	39,308	23,777	19,503	20,863	21,190	22,497	23,219	22,332
Mining	5,909	3,697	6,680	7,440	7,181	4,323	4,580	6,095
Manufacturing	171,668	84,259	106,782	116,525	109,950	103,730	112,688	121,035
Trade	96,364	43,288	44,099	48,450	48,029	55,182	61,875	65,978
Services	139,124	43,161	44,316	49,061	48,903	51,123	59,103	60,983
Others	35,053	26,951	47,620	65,255	67,523	75,163	79,707	88,987

1) Excluding inter-bank loans, loans to the Central Government and non-residents, and aid counterpart funds

Table 41
Commercial Banks' Credits in Rupiah and Foreign Currency by Type of Credit and Economic Sector[1)]
(billions of rupiah)

Types / Sectors	1998	1999	2000	2001	2002			
					Mar.	Jun.	Sep.	Dec.
Working capital credits	**345,962**	**167,442**	**203,724**	**234,128**	**232,816**	**241,499**	**264,003**	**282,486**
Agriculture	22,058	12,162	8,693	8,748	9,177	9,715	10,421	10,336
Mining	3,880	2,368	3,796	1,197	2,656	2,504	2,621	2,498
Manufacturing	121,867	61,278	80,572	88,208	82,267	76,132	82,950	89,555
Trade	72,065	36,181	36,318	40,360	40,450	46,661	52,895	55,804
Services	91,039	28,502	26,725	30,360	30,743	31,324	35,409	35,306
Others	35,053	26,951	47,620	65,255	67,523	75,163	79,707	88,987
Investment credits	**141,464**	**57,691**	**65,276**	**73,466**	**69,960**	**70,519**	**77,169**	**82,924**
Agriculture	17,250	11,615	10,810	12,115	12,013	12,782	12,798	11,996
Mining	2,029	1,329	2,884	6,243	4,525	1,819	1,959	3,598
Manufacturing	49,801	22,981	26,210	28,317	27,683	27,598	29,738	31,480
Trade	24,299	7,107	7,781	8,090	7,579	8,521	8,980	10,174
Services	48,085	14,659	17,591	18,701	18,160	19,799	23,694	25,676
Others	-	-	-	-	-	-	-	-
T o t a l	**487,426**	**225,133**	**269,000**	**307,594**	**302,776**	**312,018**	**341,172**	**365,410**
Agriculture	39,308	23,777	19,503	20,863	21,190	22,497	23,219	22,332
Mining	5,909	3,697	6,680	7,440	7,181	4,323	4,580	6,095
Manufacturing	171,668	84,259	106,782	116,525	109,950	103,730	112,688	121,035
Trade	96,364	43,288	44,099	48,450	48,029	55,182	61,875	65,978
Services	139,124	43,161	44,316	49,061	48,903	51,123	59,103	60,983
Others	35,053	26,951	47,620	65,255	67,523	75,163	79,707	88,987

1) Excluding inter-bank loans, loans to the Central Government and non-residents, and aid counterpart funds

Table 42
Commercial Banks' Credits in Rupiah and Foreign Currency by Group of Banks and Economic Sector[1)]
(billions of rupiah)

Groups / Sectors	1998	1999	2000	2001	2002 Mar.	2002 Jun.	2002 Sep.	2002 Dec.
1. State banks	**220,747**	**112,288**	**102,061**	**117,104**	**115,687**	**122,495**	**133,345**	**145,984**
Agriculture	17,012	15,516	11,209	12,034	12,151	13,319	13,588	13,632
Mining	1,989	1,360	2,522	5,554	5,212	3,106	3,107	4,040
Manufacturing	84,510	38,489	34,878	40,099	39,523	39,564	43,832	48,155
Trade	43,601	21,958	16,431	17,973	17,489	20,453	22,956	24,144
Services	55,792	19,945	16,370	15,537	14,531	15,577	18,248	19,835
Others	17,843	15,020	20,651	25,907	26,781	30,476	31,614	36,178
2. Private National Bank	**193,361**	**56,012**	**82,425**	**101,872**	**103,272**	**111,064**	**125,114**	**136,981**
Agriculture	20,272	5,740	4,987	6,049	6,034	6,219	6,505	6,383
Mining	2,414	371	863	838	914	488	713	1,209
Manufacturing	45,416	14,421	22,914	28,237	27,328	26,546	30,373	34,192
Trade	40,687	13,307	21,656	23,401	24,013	27,930	31,494	33,869
Services	72,058	15,605	17,500	22,162	22,609	24,710	28,150	30,541
Others	12,514	6,568	14,505	21,185	22,374	25,171	27,879	30,787
3. Regional Development Bank	**6,570**	**6,793**	**10,106**	**15,419**	**16,846**	**19,090**	**21,076**	**21,518**
Agriculture	354	853	527	536	627	784	939	969
Mining	19	18	65	188	276	101	170	121
Manufacturing	409	190	249	257	258	288	325	325
Trade	1,053	816	1,182	2,108	2,452	3,004	3,443	3,693
Services	1,820	1,376	1,260	1,410	1,509	2,030	2,752	2,562
Others	2,915	3,540	6,823	10,920	11,724	12,883	13,447	13,848
4. Foreign and Joint Bank	**66,748**	**50,040**	**74,408**	**73,199**	**66,971**	**59,369**	**61,637**	**60,927**
Agriculture	1,670	1,668	2,780	2,244	2,378	2,175	2,187	1,348
Mining	1,487	1,948	3,230	860	779	628	590	725
Manufacturing	41,333	31,159	48,741	47,932	42,841	37,332	38,158	38,363
Trade	11,023	7,207	4,830	4,968	4,075	3,795	3,982	4,272
Services	9,454	6,235	9,186	9,952	10,254	8,806	9,953	8,045
Others	1,781	1,823	5,641	7,243	6,644	6,633	6,767	8,174
5. Total (1 through 4)	**487,426**	**225,133**	**269,000**	**307,594**	**302,776**	**312,018**	**341,172**	**365,410**
Agriculture	39,308	23,777	19,503	20,863	21,190	22,497	23,219	22,332
Mining	5,909	3,697	6,680	7,440	7,181	4,323	4,580	6,095
Manufacturing	171,668	84,259	106,782	116,525	109,950	103,730	112,688	121,035
Trade	96,364	43,288	44,099	48,450	48,029	55,182	61,875	65,978
Services	139,124	43,161	44,316	49,061	48,903	51,123	59,103	60,983
Others	35,053	26,951	47,620	65,255	67,523	75,163	79,707	88,987

Table 43
Flow of Banknotes in Bank Indonesia Head Office and Regional Offices
(trillions of rupiah)

Office	1998		1999		2000		2001		2002	
	Inflow	Outlow	Inflow	Outlow	Inflow	Outlow	Inflow	Outlow	Inflow	Outlow
Jakarta	24.2	39.9	24.4	47.2	33.2	51.4	34.9	53.7	37.7	62.3
Bandung	17.9	14.7	22.2	17.1	28.0	20.4	37.6	23.7	40.6	26.2
Semarang	14.5	9.3	17.8	13.6	20.2	15.1	25.5	17.4	27.4	19.1
Surabaya	18.8	18.5	23.4	23.9	28.8	28.6	37.9	33.5	40.4	36.8
Medan	9.4	10.3	11.4	12.8	11.5	11.9	15.1	15.3	16.7	17.7
Padang	5.8	8.7	6.5	11.7	7.8	13.1	10.1	14.9	12.1	16.4
Makassar	7.3	8.8	8.7	10.0	10.4	12.4	13.8	14.9	15.1	16.8
Banjarmasin	4.8	7.2	6.1	9.0	7.8	11.2	10.1	13.4	11.4	15.4
Total	**102.7**	**117.4**	**120.5**	**145.3**	**147.7**	**164.1**	**185.0**	**186.8**	**201.4**	**210.7**

Table 44
Share of Currency Outflow by Denomination in Bank Indonesia Head Office and Regional Offices
(percent)

Office	Rp100,000.00	Rp50,000.00	Rp20,000.00	Rp10,000.00	Rp5,000.00	<= Rp1,000.00	Total
Jakarta	42	38	12	5	2	1	100
Bandung	51	33	11	3	1	1	100
Semarang	50	33	11	4	1	0	100
Surabaya	49	38	7	4	1	1	100
Medan	47	36	10	4	2	1	100
Padang	43	34	13	8	2	1	100
Makassar	44	35	14	4	2	1	100
Banjarmasin	47	34	12	5	2	1	100

Table 45
Flow of Coins in Bank Indonesia Head Office and Regional Offices
(billions of rupiah)

Offices	1998		1999		2000		2001		2002	
	Inflow	Outlow	Inflow	Outlow	Inflow	Outlow	Inflow	Outlow	Inflow	Outlow
Jakarta	4.4	105.5	2.2	117.7	4.1	184.5	0.1	196.9	0.6	187.7
Bandung	10.8	12.9	11.1	14.8	15.2	21.0	16.5	28.5	24.9	25.6
Semarang	13.9	8.3	12.2	13.2	14.3	14.4	17.0	15.6	20.5	12.9
Surabaya	1.2	32.8	2.2	29.7	1.8	33.5	4.0	44.2	2.5	50.0
Medan	3.3	11.2	1.1	13.1	0.4	14.0	0.7	24.1	1.0	24.9
Padang	0.3	14.1	0.3	9.7	0.3	12.3	0.5	21.8	0.5	24.8
Makassar	0.5	12.6	0.6	11.2	1.1	10.9	0.5	20.8	0.8	16.5
Banjarmasin	0.7	15.5	0.6	11.4	1.4	11.0	0.8	15.6	0.6	19.6
Total	**35.1**	**212.9**	**30.3**	**220.8**	**38.6**	**301.6**	**40.1**	**367.5**	**51.4**	**362.0**

Tabel 46
World Economic Growth
(percent)

Countries	1998	1999	2000	2001	2002*
World	**2.8**	**3.6**	**4.7**	**2.2**	**2.8**
Industrial countries	**2.7**	**3.4**	**3.8**	**0.8**	**1.7**
7 major industrial countries	2.8	3.0	3.4	0.6	1.4
United States	4.3	4.1	3.8	0.3	2.2
Japan	-1.2	0.8	2.4	-0.3	-0.5
Germany	2.0	2.0	2.9	0.6	0.5
France	3.5	3.2	4.2	1.8	1.2
Italy	1.8	1.6	2.9	1.8	0.7
United Kingdom	2.9	2.4	3.1	1.9	1.7
Canada	4.1	5.4	4.5	1.5	3.4
Others	2.2	5.0	5.3	1.6	2.6
Developing countries	**3.5**	**4.0**	**5.7**	**3.9**	**4.2**
Africa	3.4	2.8	3.0	3.5	3.1
Middle East. Malta and Turkey	3.6	1.2	6.1	1.5	3.6
Latin America	2.3	0.2	4.0	0.6	-0.6
Asia	4.0	6.1	6.7	5.6	6.1
NIEs Asia	-3.5	6.9	7.5	-0.1	3.8
People's Republic of China	7.8	7.1	8.0	7.3	7.5
Indonesia	-13.1	0.8	4.8	3.3	3.5
Singapore	-0.1	6.9	10.3	-2.0	3.6
Malaysia	-7.4	6.1	8.3	0.5	3.5
Thailand	-10.5	4.4	4.6	1.8	3.5
Philippines	-3.8	7.6	-0.8	-3.4	1.2
Vietnam	3.5	4.2	5.5	5.0	5.3
Countries in transition [1]	**-0.8**	**3.6**	**6.6**	**5.0**	**3.9**
Central and Eastern Europe	2.4	2.2	3.8	3.0	2.7
Russia	-4.9	5.4	9.0	5.8	4.4
Transcaucasus dan Central Asia	2.5	4.6	5.3	-	-

1) Excl. Belarus and Ukraine
Sources: – IMF, *World Economic Outlook*, December 2001
– Bank Indonesia

Table 47
World Inflation Rate
(percent)

Countries	1998	1999	2000	2001	2002*
World	**2.5**	**3.0**	**-**	**-**	**-**
Industrial countries	**1.5**	**1.4**	**2.3**	**2.2**	**1.4**
7 major industrial countries	1.3	1.4	-	2.1	1.2
United states	1.6	2.2	3.4	2.8	1.5
Japan	0.6	-0.3	-0.6	-0.7	-1.0
Germany	0.6	0.7	2.1	2.4	1.4
France	0.7	0.6	1.8	1.8	1.8
Italy	1.7	1.7	2.6	2.7	2.4
United Kingdom	2.7	2.3	2.1	2.1	1.9
Canada	1.0	1.7	2.7	2.5	1.8
Others	2.5	1.3	2.4	2.9	2.3
Developing Countries	**10.5**	**6.9**	**6.1**	**5.7**	**5.6**
Africa	10.9	12.3	14.3	13.1	9.6
Middle East, Malta and Turkey	27.6	23.6	19.6	17.2	17.1
Latin America	9.8	8.9	8.1	6.4	8.6
Asia	7.7	2.5	1.9	2.6	2.1
NIEs Asia	4.4	0.3	1.1	1.9	1.1
People's Republic of China	-0.8	-1.4	0.4	0.7	-0.4
Indonesia	58.0	20.70	3.8	11.5	11.9
Singapore	-0.3	0.2	1.1	1.0	-
Malaysia	5.3	3.0	1.6	1.4	1.8
Thailand	8.1	0.5	1.6	1.7	0.7
Philippines	9.7	8.5	4.3	6.1	4.0
Vietnam	7.7	7.6	-1.7	0.1	4.1
Countries in transition[1)]	**20.9**	**43.9**	**20.2**	**15.9**	**11.3**
Central and Eastern Europe	17.2	20.6	12.8	9.6	6.1
Russia	27.8	85.9	20.8	20.7	15.8
Transcaucasus and Central Asia	15.3	15.4	14.8	-	-

Sources :
– IMF, *World Economic Outlook*, September 2002
– Bank Indonesia
– BPS
– The Economist

Table 48
Interest Rates (%) and Exchange Rates

Description	1998	1999	2000	2001	2002*
Interest rates in industrial countries					
Short term	4.00	3.50	4.50	3.20	2.30
Long term	4.50	4.60	5.00	4.40	4.20
LIBOR 6 months					
US $	-	5.50	6.60	3.70	2.10
Yen	0.20	0.30	0.20	0.10	
Euro		-	3.00	4.60	4.10
3.40					
Exchange Rates					
Yen/US $	130.91	113.90	107.80	121.50	124.00
DM/US $	1.76	1.83	2.12	2.18	-
US $/GBP	1.66	1.62	1.52	1.44	1.49

Souces : IMF, *World Economic Outlook*, September 2002

Table 49
World Trade Volume and Price
(annual percent change)

Indicator	1998	1999	2000	2001	2002*
Volume	**4.3**	**5.5**	**12.6**	**-0.1**	**2.1**
Price					
Industrial goods	-1.8	-2.0	-5.2	-2.3	2.6
Non-oil and gas primary commodities	-14.7	-7.0	1.8	-5.4	4.2
Oil	-32.1	37.5	57.0	-14.0	0.5

Source : IMF, *World Economic Outlook*, September 2002

Table 50
Current Accounts in Industrial and Developing Countries
(percent of GDP)

Country	1998	1999	2000	2001	2002*
7 major industrial countries					
United States	-2.5	-3.5	-4.2	-3.9	-4.6
Japan	3.2	2.4	2.5	2.1	3.0
Germany	-0.2	-0.9	-1.1	0.1	1.9
France	2.7	2.6	1.5	1.8	1.9
Italy	1.7	0.5	-0.5	0.1	0.2
United Kingdom	-	-1.1	-2.0	-2.1	-2.1
Canada	-1.8	0.2	2.6	2.8	1.7
Developing Countries					
People's Republic of China	3.4	1.6	1.9	1.5	1.5
Indonesia	4.3	4.10	5.3	4.7	2.7
Singapore	20.9	21.1	16.7	20.4	2.7
Malaysia	12.9	15.9	9.4	8	7
Thailand	12.8	10.2	7.6	5.4	3.5
Philippines	2.0	10.0	11.3	6.3	3.3

Source : IMF, *World Economic Outlook*, September 2002

Appendix G

Banknotes Specimen Issued in 2002

Special Coins
Commemoration of One Hundred years of Bung Hatta
Rp500,000 Dan Rp25,000 Denomination
August 12, 2002

Coin Characteristics			
No	Description	Rp500,000	Rp25,000
1	Material	Gold	Silver
2	Content	0.9990	0.9990
3	Color	Golden Yellow	Silver White
4	Shape	Round (Circle)	Round (Circle)
5	Diameter	28.00 mm	38.61 mm
6	Weight	15.00 gram	28.29 gram
7	Quality	Proof	Proof

Gold

Silver

Appendix H

Abbreviations

AAOIFI	:	Accounting and Auditing Standards for Islamic Institutions
ABF	:	Asian Bond Fund
ABS	:	Automatic Bidding System
ADB	:	Asian Development Bank Indonesia
AFDM	:	ASEAN Finance and Central Bank Deputies Meeting
AFMM	:	ASEAN Finance Ministers Meeting
AFTA	:	Asian Free Trade Area
ALMA	:	Asset and Liquidity Management
APEC	:	Asia-Pacific Economic Cooperation
APG	:	Asia Pacific Group on Money Laundering
API	:	Asset Price Index
Apr	:	April
APSUN	:	Government Securities Traders Association
ARBC	:	ASEAN Rubber Business Club
ASA	:	ASEAN Swap Arrangement
ASBISINDO	:	Association for Indonesia Sharia Banks
ASEAN	:	Association of Southeast Asia Nations
ATM	:	Automatic Teller Machine
Aug	:	August
BAPEPAM	:	Capital Market Supervisory Agency
BBKU	:	Frozen Banks
BBM	:	Fuel (oil)
bbwi	:	Indonesia's western time zone
BCA	:	Bank Central Asia
BCPs	:	Basel Core Principals
BDS	:	Deposit slip
BEER	:	Bilateral Effective Exchange Rate
BER	:	Book Entry Registry
BES	:	Surabaya Stock Exchange
BG	:	Non-negotiable Payment Order to Account Beneficiary
BI	:	Bank Indonesia
BIES	:	Bulletin of Indonesian Economic Studies
BII	:	Bank International Indonesia
BI-RTGS	:	Bank Indonesia's Real Time Gross Settlement
BIS	:	Bank for International Settlement
BI-SKRIP	:	Bank Indonesia Clearing System, Registry and Government Bond Management

BPKP	:	Finance and Development Supervisory Board
BKD	:	Rural Credit Agency
BKPM	:	Investment Coordinating Board
BLS	:	Baseline Economic Survey
BNI	:	Bank Negara Indonesia
BOP	:	Balance of Payments
Botasupal	:	Coordinating Board for Eradication Counterfeit Money
BPD	:	Regional Bank
BPHTB	:	Excise on Acquisition of Land and Building Rights
BPR	:	Rural Credit Bank
BPRS	:	Sharia Rural Credit Bank
bps	:	Basis Points
BPS	:	Central Statistic Agency (Statistic Indonesia)
BRER	:	Bilateral Real Exchange Rate
BRI	:	Bank Rakyat Indonesia
BSA	:	Bilateral Swap Arrangement
BTN	:	Bank Tabungan Negara
BTO	:	Take Over Bank
Bulog	:	National Logistic Agency
BUMN	:	State-Owned Enterprises
BUSD	:	Private National Foreign Exchange Bank
BUSND	:	Private National Non-foreign Exchange Bank
CA	:	Basel Capital Accord
CAMEL	:	Capital, Asset, Management, Earnings and Liquidity.
CAR	:	Capital Adequacy Ratio
CBS	:	Net Claims on Business Sectors
CCI	:	Consumer Confidence Index
CDMA	:	Code Division Multi Access
CECD	:	Organization for Economic Cooperation and Development
CGI	:	Consultative Group on Indonesia
Cif	:	Cost on Freight
CPI	:	Consumer Price Index
CPs	:	Core Principals
CR	:	Central Registry
CRC	:	Cold Rolled Coil
CSA	:	Centralized Settlement Account
CTC	:	Counter Terrorism Committee
Dec	:	December
DJIA	:	Dow Jones Industrial Average

DPR	:	The House of Representatives
DRI	:	Danareksa Research Institute
DSR	:	Debt Service Ratio
DVP	:	Delivery Versus Payment
ECB	:	European Central Bank
ECB	:	European Central Bank
EFF	:	Extended Fund Facility
EMEAP	:	Executive Meeting of East Asia and Pacific
EO	:	Exchange Offer
ETP	:	Exposure Training Program
EU	:	European Union
FAASM	:	Fixed Asset Accounting Simulation Model
FASBI	:	Bank Indonesia Deposit Facility
FATF	:	Financial Actions Task Force on Money Laundering
FDI	:	Foreign Direct Investment
FDR	:	Financing to Deposit Ratio
Feb	:	February
FKSPN	:	National Payment System Communication Forum
Fob	:	free on board
FoP	:	Free of Payment
FPJP	:	Short-term Funding Facility
FR	:	Fixed Rate
FSF	:	Financial Stability Forum
GAM	:	Free Aceh Movement
GARCH	:	General Auto-regressive Conditional Heteroscidasticity
GBP	:	Great Britain Poundsterling
GDP	:	Gross Domestic Product
GFA	:	Gross Foreign Asset
GNP	:	Gross National Product
GTZ	:	Gessenschaft fur Technische Zusammenarbeit
GWM	:	Minimum Reserve Requirements
HB	:	Hedge Bonds
HIPC	:	Highly Indebted Poor Countries
HJE	:	Retail Price for Cigarettes
HKMA	:	Hong Kong Monetary Authority
HRC	:	Hot Rolled Coil
HSBC	:	Hong Kong- Shanghai Bank Corporation
IAI	:	Association for Indonesian Accountants
IBRA	:	Indonesian Bank Restructuring Agency

IBRD	:	International Bank for Reconstruction and Development
ICA	:	Inter Company/Office Account
ICOR	:	Incremental Capital-Output Ratio
ICS	:	Image Clearing System
IDB	:	Islamic Development Bank
IFSB	:	Islamic Financial Services Board
IFSO	:	Islamic Financial Services Organization
IGGI	:	Inter-Governmental Group on Indonesia
IGSTS	:	Indonesian Government Securities Trading System
IIFM	:	International Islamic Financial Market
IMF	:	International Monetary Fund
IOUs	:	Government Securities
IPOs	:	Initial Public Offerings
IPP	:	Independent Power Production
IRB	:	Internal Rating Based
IRFCI	:	International Reserve and Foreign Currency Liquidity
IT	:	Information Technology
ITRCo	:	The International Tripartite Rubber Company
Jabotabek	:	Jakarta-Bogor-Tanggerang-Bekasi Area
Jan	:	January
JCI	:	Jakarta Composite Index
JIBOR	:	Jakarta Inter Bank Offer Rate
JITF	:	Jakarta Initiative Task Force
JPY	:	Japanese Yen
JSE	:	Jakarta Stock Exchange
Jul	:	July
Jun	:	June
Keppres	:	Presidential Decree
KHM	:	Minimum Level of Basic Needs
KI	:	Investment Credit
KK	:	Consumption Credit
KLBI	:	Bank Indonesia Liquidity Credit
KMK	:	Working Capital Credit
KUD	:	Village Cooperative Unit
KYC	:	Know Your Customer
LDR	:	Loan to Deposit Ratio
LIBOR	:	London Inter Bank Offer Rate
LNG	:	Liquefied Natural Gas
LOI	:	Letter of Intent

LPG	:	Liquefied Petroleum Gas
Mar	:	March
May	:	May
MMBTU	:	Mille Mille British Thermal Unit
MOPS	:	Mid Oil Platt's Singapore
MoU	:	Memorandum of Understanding
MPR	:	People's Consultative Assembly
m-t-d	:	month to date
m-t-m	:	month to month
MTon	:	Million Ton
NBER	:	National Bureau of Economic Research
NCCT	:	Non-cooperative Countries and Territories
NCG	:	Net Claims of Government
NCS	:	Net Capital Stock
NDA	:	Net Domestic Asset
NFA	:	Net Foreign Assets
NGO	:	Non Governmental Organization
NIEs	:	Newly Industrialized Economies
NIM	:	Net Interest Margin
NIR	:	Net International Reserve
NOI	:	Net Other Items
Nov	:	November
NPF	:	Non Performing Financing
NPL	:	Non-Performing Loan
NPV	:	Net Present Value
NTB	:	West Nusa Tenggara
NU	:	Nadathul Ulama
O/N	:	Overnight
OCA	:	Overseas Current Account
Oct	:	October
ODA	:	Official Development Assistance
OECD	:	Organization for Economic Cooperation and Development
OMO	:	Open Market Operation
OPEC	:	Organization of Petroleum Exporting Countries
PAPS	:	Sharia Banking Audit Guidelines
PAPSI	:	Indonesian Sharia Banking Accounting Guidelines
PBI	:	Bank Indonesia Regulation
PC	:	Performance Criteria
PCA	:	People's Consultative Assembly

Pefindo	:	Indonesian Rating Company
PERC	:	Political and Economic Risk Consultancy Ltd
PI	:	Performance Indicator
PIPU	:	Money Market Information Center
PLTD	:	Diesel Power Plant
PLTGU	:	Gas and Steam Power Plant
PLTP	:	Geothermal Power Plant
PLTU	:	Steam Power Plant
PMDN	:	Domestic Investment
PNM	:	Permodalan Nasional Madani
PPATK	:	Center for Reporting and Analysis on Financial Transaction
PPM	:	Post Program Monitoring
PRC	:	People's Republic of China
PRGF	:	Poverty Reduction and Growth Facility
ProFI	:	Promotion of Small Financial Institutions
PRSP	:	Poverty Reduction Strategy Papers
PSAK	:	Preparation of Statement of Financial Accounting Standards
PSAKS	:	Preparation of Statement of Financial Accounting Standards for Sharia Bank
PSTN	:	Public Switch Telephone Network
PT	:	Company
PTTB	:	Unfit Bank Notes
PUAS	:	Inter-Sharia Banks Money Market
PYD	:	Financing Rendered
Q	:	Quarter
q-t-q	:	quarter to quarter
Qtr	:	Quarter
RDMS	:	Reuters Monitor Dealing System
REER	:	Real Effective Exchange Rate
RIA	:	Road map for Integration of ASEAN
ROA	:	Return on Asset
ROE	:	Return on Equity
ROSC	:	Reports on the Observance on Standards and Codes
Rp	:	Rupiah
S&P	:	Standard and Poor
SAL	:	Accumulated savings from previous budget
SBA	:	Stand by Arrangement
SBI	:	Bank Indonesia Certificate
SBIs	:	Systematically Important Banks
SBC	:	State Budget Calculation

SD	:	Selective Default
SDRM	:	Sovereign Debt Restructuring Mechanism
SE	:	Circular Letter
SEACEN	:	Southeast Asian Central Banks
Sep	:	September
SIABE	:	Export Oriented Agroindustry Information System
SIBOR	:	Singapore Inter Bank Over Rate
SID	:	Debtor Information System
SIPS	:	Systematically Important Payment Systems
SI-PUK	:	Integrated Information System for Small Business Development
SMEs	:	Small Medium Enterprises
SNA	:	Standardized National Account
SOEs	:	State Owned Enterprises
SPKUI	:	Investment Decision Support Information System
SPPP	:	Settlement Order
SPPR	:	Transferring Securities Ownership
SR	:	Sub Registry
SSK	:	Financial System Stability
SSSS	:	Scripless Securities Settlement System
SUN	:	Government Securities
SUP	:	Government Securities
SWBI	:	Bank Indonesia Wadiah Certificate
TAF	:	The Asia Foundation
T-Bills	:	Treasury Bills
Tbk	:	go public
TDL	:	Base Electricity Tariff
THB	:	Thailand Baht
TKI	:	Indonesian Workers
ToF	:	Training of Facilitators
ToT	:	Training of Trainers
TPT	:	Textile and Textile Product
TSLs	:	Two Step Loans
UBF	:	Unused Budgettary Funds
UK	:	United Kingdom
UKM	:	Small Scale Enterprises
UMP	:	Provincial Minimum Wages.
UMR	:	Regional Minimum Wages
UN	:	United Nation
UNDP	:	United Nations Development Program

UNESCO	:	United Nations Education Scientific and Cultural Organization
US	:	United States
USAID	:	United States Agency for International Development
UUS	:	Sharia Business Unit
VAT	:	Value Added Tax
VR	:	Variable Rate
VRB	:	Variable Rate Bond
WEO	:	World Economic Outlook
WPI	:	Wholesale Price Index
WTC	:	World Trade Center
WTO	:	World Trade Organization
y-o-y	:	year on year