This report presents a comprehensive review on "The Evaluation of Economic Condition in 2003 and the Economic Prospect Policy Directions for the Year 2004" A preliminary version of this material was published through the media on the begining of February 2004 pursuant to article 58 of Act number 23 of 1999 on Bank Indonesia

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2003 Economic Report on 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

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

Reporting period is January 1, 2003 to December 31, 2003

Source of data is Bank Indonesia unless mentioned otherwise

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Preface

The year 2003 witnessed a major achievement in Indonesia, namely the return of macroeconomic stability. This was by no means accident. Rather, it was the hard-won result of disciplined and consistent fiscal and monetary policies, accompanied by support from all elements of the nation in maintaining socio-political stability. By way of a few examples of our recent successes, the exchange rate recorded its longest stretch of stability since the onset of the crisis; inflation has come way down, indeed to its lowest rate of the past two decades with the exception of 1999 following the depths of the economic collapse; and SBI interest rates declined with such consistency that they are now approaching historical lows. These accomplishments have provided a solid basis for economic recovery; they have given a boost to our recuperating financial sector; and they have heightened international confidence in our economic prospects.

For its part, the national banking system continued its slow recovery from the deep crisis. Indicators of success in this regard include a strengthened capital structure, lower non-performing loans and higher profitability. Nonetheless, persistent problems continued to hinder the banking sector's performance, like real sector weaknesses and incomplete corporate restructuring. Despite the existing excess liquidity in the banking sector, many observers remained deeply pessimistic over the prospects for a quick return to normal bank intermediation.

At Bank Indonesia (BI), 2003 was marked by the resolution of various key issues that had been hampering us in performing our duties. The disputatious problem of Bank Indonesia Liquidity Assistance (BLBI) was finally resolved through an agreement among Bank Indonesia, the Government and Parliament. Also, amendment of the Bank Indonesia Act—which had been pending for more than three years—was finally completed. The most contentious issue in the amendment entailed a delicate balancing of the central bank's independence versus its public accountability. There were some other key aspects to the amendment, too, for example, the Financial Safety Net (FSN), transfer of banking supervision to the Financial Services Supervisory Agency (LPJK) and the election of Bank Indonesia's Board of Governors.

In 2003, the management of our economy also saw a new era, namely the government's decision to end our program with the IMF. As year-end approached, nervousness heightened somewhat as to how financial markets would react. Would the markets agree that Indonesia was ready to step out on its own once again? Was there enough confidence that we would be able to manage our own affairs responsibly? In the event, the markets' judgement was highly favorable and our IMF program terminated at year-end without a hint of turbulence in financial markets.

Nonetheless, an end to our IMF program will undoubtedly change our paradigm for economic management, beginning in 2004. In broad terms, we will have to manage our economy in a more focused, consistent, and disciplined manner. For that purpose, the Government and Bank Indonesia have prepared a post-IMF economic program, referred to as the White Paper. *This will serve as our agenda for continuing economic reform and as our basis for sustained economic growth.*

Despite these many notable successes, a number of problems continue to drag the progress of our economic development. Most importantly, the recent pace of economic growth has been too slow to provide jobs for adequate numbers of new entrants to the labor force. Consequently, in 2003 open unemployment rose to roughly 9.8% of the labour force, an exceptionally high level by Indonesian standards. Likewise, recent rates of economic growth have been insufficient to raise national per capita income back to its pre-crisis level.

These failures are largely due to our nation's persistent structural weaknesses in the areas of legal uncertainty, labour issues and investment regulations. These weaknesses have hampered investment and damaged the international competitiveness of our exports. As a consequence, economic growth has come to depend upon consumption, with investment and exports making a minor contribution. If we hope to make any significant advance in the living standards of Indonesians, we will need a faster pace of economic activity, underpinned especially by increased investment. This is essential for creating of more jobs and raising incomes and living standards.

For 2004 to be a successful year, we need to address collectively these challenges. For Bank Indonesia, the top priority is the maintenance of monetary stability because we believe that this is a prerequisite for economic development. Without monetary stability in place, it will be very difficult to achieve high sustainable growth, which in turn will help realizing a just and prosperous well being of the Indonesian people. Efforts in this regard—in the midst of an uncertain socio-political and economic climate—necessarily entails perseverance and discipline, with no easy shortcuts.

Looking ahead, taking into account these many challenges and opportunities, Bank Indonesia is optimistic that macroeconomic performance will keep improving in 2004. To be more specific, we predict that inflation will remain at a comfortable level, of around 5.5% +/- 1%; the rupiah exchange rate will be *relatively stable; interest rates will tend to decline further; and domestic and international confidence in Indonesia's economic prospects will improve further. In view of all these developments, Bank Indonesia is optimistic that economic growth in the range of 4-5% is attainable in 2004.*

This can be only a brief sketch of Indonesia's economic performance in 2003 and the prospects for 2004. A more comprehensive account is provided in the rest of this ***2003 Economic Report on Indonesia****. Actually, this report is another of Bank Indonesia's Annual Reports, but its title has been changed beginning this year, to more accurately reflect its contents. This is not just report on the implementation of Bank Indonesia's tasks; it is a comprehensive review of Indonesian economic developments in 2003.*

Finally, on behalf of the Bank Indonesia Board of Governors, I wish to express my appreciation to all executives and staff of Bank Indonesia for having selflessly applied their minds and energies in a collaborate way to comply with Act No. 23 of 1999 on Bank Indonesia. My gratitude also goes to the Government, banking and business circles and other elements of our country for their co-operation with Bank Indonesia to date. Going forward, our greatest challenge will be to safeguard our macroeconomic stability as we navigate the socio-political and economic dynamics of 2004. As Indonesians, our greatest strengths are cooperation and harmonious coordination of mutual interests. Let us make our greatest strengths the main instruments to effect meaningful change towards a brighter future for our nation.

May God the Almighty spare us from doom, shower us with His blessings and protect us in our work.

GOVERNOR OF
BANK INDONESIA

Burhanuddin Abdullah

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Chapter 1: Overview

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The year 2003 saw favorable economic performance with stability strengthening as evidenced by the appreciation of rupiah, lower interest and inflation rates, and higher economic growth. One key factor in this regard was the pursuit of mutually supportive monetary and fiscal policies, which helped maintain the momentum of economic recovery. Nevertheless, deeply rooted structural weaknesses remained; hampering a faster economic growth rate, which is vital to providing jobs for all new entrants into the labor force.

During 2003, the Indonesian economy was confronted with serious challenges, among others, the impact of Bali bombing tragedy of 2002, the plan to exit the International Monetary Fund (IMF) program by the end of 2003, in addition to the subdued growth of the world economy. To cope with these challenges, the Government and Bank Indonesia adopted a series of policies to boost the economic recovery while maintaining macroeconomic stability.

These policies significantly contributed to improving macroeconomic performance in 2003 as reflected in the appreciation of rupiah and falling rate of inflation. This achievement appeared to surpass earlier projections as well as last year's performance. The higher economic growth was an indication of ongoing economic recovery.

Fiscal consolidation helped strengthen confidence in domestic macroeconomic stability. The pursuit of accommodative monetary policy, at a time when international interest rates were declining and country risk improving, had provided room for domestic interest rates to drop off without adverse effects on inflation and exchange rate. The world inflation rate, which has declined to a low level, also contributed to lowering domestic inflation. These, combined with continued efforts to improve the soundness and resilience of the banking system and reliability of the national payment system led to improvements in banks' performance and the achievements in maintaining macroeconomic and financial system stability. Success in this regard was supported by heightened domestic security and the public's awareness of the importance of social stability.

Amid this progress, the economy remained burdened by a number of constraints and problems. For instance, given the large debt overhang and the necessity to maintain fiscal sustainability, the government had limited capacity to stimulate economic growth. Additionally, bank intermediation which had not functioned optimally also constrained the transmission of monetary policy to the real sector. The pace of economic recovery continued to be hindered by various structural problems, especially in the areas of law enforcement and labor regulations and in the implementation of regional autonomy. These led economic growth to continue to rely on consumption whereas that of investment and exports was still limited. This situation was aggravated by lack of an integrated policy strategy to foster a strong and highly competitive industrial sector. As a result, the growth of manufacturing (the largest sectoral component of GDP) remained low compared with the pre-crisis period. Consequently, economic growth was inadequate to absorb the growing labor force and to raise per capita income to its pre-crisis level.

The year 2004 presents new horizons for hope, optimism, as well as challenges. Sustained macroeconomic stability, improving international confidence and clarity of the economic agenda, all supported by enhanced institutional capacity—especially as regards policy formulation and decision-making at the bureaucratic and political levels—will provide a basis for higher growth in the coming years. Concurrently, 2004 marks a new phase in national economic management following completion of the IMF stabilization program, the last of the Asian crisis countries to do so. The decision to exit the IMF program was triggered by improved macroeconomic developments and strong commitment to continued economic restructuring on an autonomous basis. The year 2004 will also be a transitional year for Indonesia towards greater democracy, with a strong government supported by all segments of the nation, through direct general elections.

During a transition period unanticipated changes may occur rapidly. Under such circumstances, the maintenance of macroeconomic stability is essential. To this end, a number of short-term economic programs have been put on the post-IMF policy agenda (the White Paper). Within the broader policy framework, this short-term program is a preliminary step in efforts to maintain consistency and continuity of the long-term policies. For Bank Indonesia, the policy package stands as a main guideline in implementing macroeconomic stabilization and financial sector restructuring programs.

Against this backdrop, Bank Indonesia expects that macroeconomic stability will be maintained in 2004, as reflected in the stable and slight appreciation of Rupiah and controlled inflation rate. The rupiah exchange rate is estimated to remain stable in the range of Rp8,200 – Rp8,700 against the US dollar. The CPI inflation will be in the range of 5.5% ± 1%. Economic growth of 4% - 5% will be achievable with consumption providing the main impetus and non-oil exports making a significantly larger contribution owing to the strengthening world economy. Investment will pick up albeit at a slow pace due to various persistent, economic and non-economic fundamental weaknesses in addition to existing domestic and external risks.

Table 1.1.
Selected Macroeconomic Indicators

(Percent)

Item	2001	2002	2003
Gross Domestics Product	3.5	3.7	4.1
By Expenditure			
Consumption	3.9	4.7	4.6
Gross Fixed Captal Formation	6.5	0.2	1.4
Exsports of Goods and Service	2.9	-0.6	4.0
Imports of Goods and Service	8.2	-5.0	2.0
By Sector			
Agriculture	1.7	2.0	2.5
Manufacturing	3.1	3.4	3.5
Construction	4.4	4.9	6.7
Trade, Hotel and Restaurants	3.7	3.8	3.7
Finance, Leasing and Service Companies	5.4	5.7	6.3
Other Service	3.1	2.1	3.4
Monetary (% growth)			
M2 Growth			
- average	14.74	8.05	6.41
- end of period	12.99	4.72	8.12
M1 Growth			
- average	19.76	9.85	12.41
- end of period	9.59	7.99	16.60
Base Money Growth			
- average	17.86	9.22	10.34
- end of period	15.37	5.98	14.25
Interest Rate (%)			
SBI (1 month)	17.62	12.93	8.31
Inter Bank Money Market (overnight)	15.90	12.42	8.18
Time Deposits (1 month)	16.07	12.81	6.62
Working Capital Credit	19.19	18.25	15.07
Investment Credit	17.90	17.82	15.68
CPI Inflation (%)	12.55	10.03	5.06
Balance of Payments			
Current Acount GDP(%)	4.7	4.5	3.8
Debt Service Ratio (DSR) (%)	41.4	33.3	33.8
Foreign Reserves Equivalent to Months of Non-Oil/Gas Imports	5.9	6.6	7.1
Average Exchange Rate (Rp/$)	10.256	9.316	8.572

Sources: - BPS-Statistics Indonesia
- Bank Indonesia

Taking into account macroeconomic prospects and challenges in 2004 as well as the medium-term inflation target of 6% for 2006, monetary policy in 2004 will continue to be directed toward striking a right balance between the supply of domestic liquidity and the need for financing economic activity . To this end, the average growth of base money will be maintained in the range of 13% - 14.5%. Additionally, to nurture financial market stability, Bank Indonesia will continue the use of interest rates as a signal of its monetary policy. Macroeconomic stability will also be supported by the government's commitment to continue with fiscal consolidation measures. Given the constraints of monetary and fiscal policies, efforts to accelerate economic growth obviously call for the support of more concrete and focused measures to overcome the existing structural problems that hamper Indonesia's economic performance.

INDONESIAN ECONOMIC DEVELOPMENTS IN 2003

The Indonesian economic performance was favorable with stability remaining in check in 2003 as reflected in higher economic growth, sharply lower interest and inflation rates and stronger exchange rate with reduced volatility. Still, economic expansion fell well short of that needed to absorb the growing labor force, causing unemployment to rise further. This unsatisfactory condition was due, among others, to persistent structural problems, the adverse impact of the Bali bombing and the subdued world economy, especially in the first semester of 2003.

The continued slow pace in the expansion of world trade led to relatively low growth in volumes of Indonesian exports, especially non-oil commodities. In nominal terms, exports were mainly boosted by higher prices for non-oil commodities and oil in the international market, bringing about a significant increase in export values which led to the current account surplus in2003. Over the same period, the very low level of interest rates in tandem with the bleak business prospects in developed countries led to capital inflows into many developing countries, including Indonesia. Foreign capital inflows to Indonesia, however mostly comprised portfolio investments rather than foreign direct investment. Since the amount of portfolio investment was smaller than repayments of government and private debts, capital account deficit widened during 2003. Nevertheless, **overall balance** recorded a relatively large surplus, bringing about a significant increase in the official international reserves to $36.2 billion.[1] This amount was equivalent to 7.1 months of imports and government foreign debt obligations.

This overall surplus and the comfortable level of reserves increased the supply of foreign exchange in domestic market which strengthened confidence in the rupiah, hence contributing to sustained appreciation of **rupiah** during 2003. Other contributors included improved indicators of Indonesian country risk; attractive real interest rate differentials; and global depreciation of the US dollar.[2] On an average annual basis, rupiah appreciated by 8.71%, to Rp8,572 per US dollar, making the rupiah one of Asia's best-performing currencies in 2003. Furthermore, the appreciation was also accompanied by greater stability, which stemmed from the implementation of consistent macroeconomic policies, exchange rate stabilization policies through improvements in monitoring and supervision of foreign exchange transactions.

The appreciation of rupiah was one of the fundamental factors that pushed the inflation rate down during 2003. **CPI inflation** fell to 5.06%, half the level in 2002 (10.03%) and below the target of 2003 (9% ± 1%). Other fundamental factors contributing to the low inflation were lower inflationary expectations and limited pressure arising from output gap. These favorable fundamental

1 Not including private foreign assets amounting to around$12 billion.
2 Research by Directorate of Economic Research and Monetary Policy, Bank Indonesia, "Decomposition of Behavioral Equilibrium Exchange Rate (BEER) Equation, Reestimation of Equation per December 2003.

factors mainly reflected the outcome of the pursuit of monetary policy in the preceding year. Core inflation, which reflected the fundamental factors, eased somewhat from 6.96% in 2002 to 6.93% in 2003. This implied that the dominant factors in pushing CPI inflation down were non-fundamental, especially increased supplies of foodstuffs and government decision to delay increases of some administered prices including fuel, telephone, and electric power.

The downward trend of inflationary pressure provided room for Bank Indonesia to cut the discount rates on SBI, which induced banks to lower deposit and credit interest rates. In the course of 2003, the discount rates on 1- and 3-month SBIs fell by 462 bps and 478 bps, respectively, to 8.31% and 8.34%. In line with that, average interest rates on 1-month deposits dropped by 619 bps, to 6.62%. The rate on 3-month deposits dropped even further, by 649 bps to 7.14%. Meanwhile, credit rates declined at a slower rate, of only around 100-300 bps. These declines created conducive climate to growth in the real sector, for both investment and consumption.

Although the transmission of monetary policy to the real sector through the interest rate channel still encountered constraints (as evidenced by the limited decline in credit rates), other transmission channels worked relatively better. From the balance sheet channel, lower interest rates helped improve corporations' financial soundness, thereby increasing their capacity to obtain more financing from both bank and non-bank sources such as bonds and stocks. Through the asset price channel, it induced the partial transfer of private assets (households and corporations) into non-bank assets, which boosted key asset prices, such as stocks, private bonds, and property. Through the production cost channel, it reduced the interest component of production costs, thereby encouraging business players to invest and expand. Through the expectations channel, it strengthened both consumers and producers confidence concerning the prospects for economic recovery, which in turn encouraged consumption and business expansion. These development were reflected in improvements in a number indicators of consumers and producers expectations on the prospects for incomes, economic and business conditions.

The impact of these various transmission channels was reflected, among others, in a rise in both issuances of private bonds and stocks, and prices index. For issuing companies, improved prices of their stock meant an increase in the value of their assets, which would in turn boost investment. For the stockholding public, higher asset prices would also increase their wealth, which would stimulate domestic consumption. Private stock issuances registered with the Surabaya Stock Exchange (*BES*) rose significantly in 2003 to some Rp26 trillion. Meanwhile, the Jakarta Composite Index (*IHSG*) for the Jakarta Stock Exchange soared by 267 points, reaching 692, with new issues amounting to some Rp10 trillion. In total, the business gained nearly Rp40 trillion through the capital markets, which was not well below the increase in bank credit of some Rp65 trillion. These developments reflected a significant increase in the contribution of the capital markets in financing economic activity.

In parallel, **economic growth** accelerated somewhat increased from 3.7% in 2002 to 4.1% in 2003, slightly above the projected range at the beginning of 2003. On the aggregate demand side, all components expanded, with consumption being the main impetus for growth. Investment increased only slightly compared with the preceding year, and remained at a very low level; the sub-component of investment in the form of machinery and equipment even recorded a decline. Exports also improved relative to 2002, yet remained at a low level which was inadequate to promote higher growth.

From the supply side most sectors recorded higher growth. However, manufacturing—which has the largest multiplier effect and contribution to the economy—remained weak, suggesting that the structure of supply was not sufficiently supportive of sustained, higher economic growth. Continuing weak investment spending on machinery and equipment was one of the causes of small increases in production capacity, especially in manufacturing. The persistently high production cost also discouraged domestic production, leaving higher domestic demand to be met by increased imports. This situation in turn reduced the incentive for domestic industry to invest, hence, limiting expansion of production capacity.

Despite improved overall conditions, economic growth to date has been inadequate to raise per capita incomes back to the pre-crisis level. This stands in sharp contrast to developments of per capita incomes in nearly all neighboring countries; some have even surpassed pre-crisis levels of per capita income. Similarly, economic growth to date has been unable to absorb additions to the workforce. The number of open unemployment was estimated to rise to 10.1 million persons or some 9.8% of the labor force.[3] The relatively small increase in the demand for labor relative to the growing number of new entrants to the labor force led to stiffer competition for jobs, resulting in more highly educated manpower accepting jobs normally taken by the less educated. At the same time, the informal sector has absorbed a good part of the increase in labor force.

FACTORS AFFECTING ECONOMIC DEVELOPMENTS IN 2003

Improving macroeconomic conditions during 2003 were supported by, among others, the implementation of macroeconomic policies which was continuously directed at long-term stability while consistently maintaining the momentum of economic recovery. Meanwhile, external factors failed to support economic growth, although they have contributed to exchange rate stability. By contrast, certain fundamental factors and microeconomic policies – especially those related to investment, industrial and trade policies – have yet to make a significant contribution to the economic recovery.

External Factors

World economic growth during 2003 was slightly higher than in 2002. However, the economic recovery to date has not triggered a significant increase in world trade volume. Consequently, exports have yet to boost the domestic economy.

In advanced countries, a significant increase in economic growth did not take place until the second half of 2003 and it only occurred in the United States and Japan. Economic growth in the European countries remained low. Among the developing countries, high growth remained dominated by China, followed by Vietnam, India, and Thailand; while growth in other countries was relatively low.

The growth of world trade was lower than estimated at the beginning of 2003, and even declined compared with the preceding year. This outcome in the face of a recovery in world economic growth was due to the Iraqi war, the epidemic of SARS, and increased protectionism in some advanced countries. Meanwhile, efforts to ease various trade constraints through the WTO Conference in Cancun, Mexico, failed.

Along with the increase in global economic activity, **world inflation** tended to rise from the previous year, although it remained at a low level. In the advanced country group, inflation increased from 1.5% in 2002 to 1.9% in 2003; in developing countries, inflation rose from 5.3% to 5.9%. Low world inflation, supported by the rupiah appreciation, contributed to the decline of inflation in Indonesia during 2003.

3 Bappenas projection figures.

The price of non-oil/gas commodities in international markets increased sharply during 2003, exceeding estimates at the beginning of the year. This was partly due to the slow recovery of production activities; producers' attempts to raise prices after a steep decline in 1998 – 2001; and the dollar's depreciation. **The price of world oil** also increased sharply, approaching $30 per barrel by end of 2003. That development was due to continuing limited supplies from Iraq, decreasing oil reserves in the US, and the tough quota discipline of OPEC. The sharp price increases in oil and non-oil commodities have offset very low export volume growth, such that Indonesian exports in nominal terms did improve over the previous year.

International interest rates tended to decline and stood at levels far below those expected at the beginning of the year. This was due to the implementation of loose monetary policy in many countries in an attempt to boost continued weak economies. In light of the very low interest rates in developed countries and concerns over the growing current account and fiscal deficits of the US, investors transferred capital to developing countries in Asia and Latin America that offered more attractive yields. This development was the main impetus for international exchange rate shifts during 2003, mainly the depreciation of the US dollar against many world currencies. The momentum for dollar depreciation increased as the US government appeared to support this development as a way to narrow that country's current account deficit.

About 80% of the **international capital inflows** to developing countries during 2003 were in the form of foreign direct investment. In Asia, a large amount of the foreign investment entered countries with better economic prospects, such as China, Vietnam, and Thailand. In the meantime, Indonesia failed to capitalize this rising trend of foreign investment. The kind of foreign capital entering Indonesia was more in the form of portfolio investment for stocks and bonds, largely to take advantage of the attractive interest differential offered by domestic capital markets.

Low international interest rates and the depreciation of the dollar against various world currencies made room for lower domestic interest rates without causing negative impact on the rupiah exchange rate.

Fundamental Factors

Efforts to boost economic growth have not yet produced the expected good results because of continuing unhelpful fundamental economic conditions and various structural weaknesses in the areas of legal enforcement and labor regulations. These fundamental weaknesses have harmed **Indonesia's economic competitiveness**, on both the macro and micro sides.[4] The most current survey showed that Indonesia's growth competitiveness index ranks 72nd among 102 countries. This is a poor performance compared with most of its competitors in Asia. As regards business competitiveness, Indonesia rates 60th among 101 countries, topping only the Philippines among Asian competitors. This is one of the causes of the diminishing role of investment and exports in GDP formation in the past three years. This has hampered the economy's capacity to absorb labor because consumption (which role has expanded) has a lower multiplier effect than investment.

Rising consumption demand has been partly satisfied by imported goods, which have been increasing in volume terms since 1999 (except only 2002). This has limited investment in domestic manufacturing, which has the largest backward-forward linkages, absorbs a large number

4 World Economic Forum 2003. Growth Competitiveness Index is the composite indices of macroeconomic condition , public institution condition, and use of technology. Macroeconomic condition index encompasses macroeconomic stability, neutral government expenditure exerting no impact on domestic economy (such as debt repayment that does not contribute domestically), and country credit. Public institution condition covers continuity on contract and law enforcement, and corruption level. Use of technology covers innovation level, use of information technology and communication, and transfer of technology. Business of Competitiveness Index is a composite of company's strategy and operating value as well as the quality of domestic business climate.

of workers, and improves non-oil exports.[5] Declining investment in manufacturing was also driven by rising real wages relative to average labor productivity, which reduced the profitability of investment.[6]

Reflecting the slow growth of investment, capital **productivity** has yet to improve significantly as suggested by the relatively high ICOR in 2003 versus 1989 – 1996. Likewise, the growth of Total Factor Productivity (TFP), as an indicator of technological advancement, although improving, has not yet returned to the pre-crisis rates of growth. Similarly, average labor productivity has yet to return to the pre-crisis growth rates.

Growth in incomes, which has been slower than consumption growth in the last three years, has led to a decline in the **savings to GDP ratio**. Lower savings implies a reduced domestic capacity to finance investment. If this trend continues, within some years current account will slip into persistent deficit, thereby aggravating our dependency on foreign finance, as happened in the pre-crisis period.

CPI developments in 2003 indicated that the **inflation rate was very susceptible to supply shocks**. Effects from the supply side dominated price formation due to the significant role played by the cost component of product prices.[7] This was reflected in the large weight (some 40%) of administered prices and volatile foods in the CPI basket.

Inflation in Indonesia was also affected by the price formation process, which generally was done periodically, especially at the producer and wholesaler level. Periodical price adjustments caused **rigidities in prices**, which has implications for the length of time needed for monetary policy to influence the inflation rate. Such lags became even more extended because the impact of monetary policy on the real sector must first be transmitted through the financial sector. In these circumstances, efforts to control inflation through monetary policy need to be more forward-looking and transparent, and supported by a fiscal policy that is consistent in maintaining macroeconomic stability.

Meanwhile, the **Indonesian balance of payments** exhibited an improving trend, especially the return of the private sector in both current and capital accounts. The private sector, which during the first four years of the economic crisis was always in a deficit position, has been in surplus in the past two years. This implies a steady improvement in the balance between foreign currency demand and supply in the private sector, thereby contributing significantly to the rupiah's appreciation in this period.

However, the current account—and especially non-oil/gas exports—has not yet improved, both by country of destination and by type of commodity. By destination, non-oil/gas exports are still heavily dependent upon demand from US, Japan and Singapore. By commodity, non-oil/gas exports are still dominated by a few principal products, *inter alia*, textiles, wood products, electric equipment, paper and footwear. Among primary non-oil/gas export commodities, paper, copper and animal products are the only ones that do not have major competitors in the Asian region. From the side of private capital flows, rising inflows of portfolio investment in the last two years have not been balanced by foreign direct investment. This has made the balance of payments (BOP) susceptible to quick reversals of short-term capital in the event that negative sentiment were to build among investors.

Macroeconomic Policies

Monetary Policy

Monetary policy in 2003 was still directed at achieving the target for inflation. In this regard, monetary policy was operationally focused on controlling base

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5 Input-Output Simulation Model indicates that 10% increase at final demand on the manufacturing sector leads to a 3.5% GDP Growth (Idris, Rendra Z, "Decreasing Interest Rates, Economic Growth, and Disinflation Process," Research Note, Bank Indonesia, March 2003)

6 Yanuarti, Tri, Akhis Hutabarat, Rendra Z. Idris, 'Labour and Productivity' , Research Note, Bank Indonesia, December 2003.

7 Bank Indonesia Survey, A Research on Dynamics of Wage and Price Formation, 2003.

money to suit real economic needs. However, the characteristics of inflation in Indonesia, which are driven more by supply pressures, make it difficult to control inflation efficiently through control of money in circulation.[8] In such a situation, the strategy for control of base money maintained, in such away, that could still create opportunity for prudently lowering interest rates in order to give room for improving the supply side of the economy.

Within its monetary policy framework focusing on **achieving the target for base money**, Bank Indonesia at the beginning of the year set the 2003 target for average base money growth at around 13%. This setting was based on prospects for economic growth of 3.5% - 4%; an appreciating exchange rate hovering in the range of Rp8,800 - Rp9,200 per dollar; and an inflation target of 9% with deviation of ± 1%. During the period January-July 2003, base money was always well below its target. The inflation rate tended to decline below its target and the stronger rupiah exchange rate have caused the public's need for cash to be much less than expected.

In view of such base money developments, at the beginning of August 2003 Bank Indonesia decided to reduce the 2003 base money target to 12%. This adjustment was based on the latest estimates of macroeconomic conditions, namely economic growth of 4%, the exchange rate at around Rp8,536 per dollar and inflation at around 6%.

Excess bank liquidity colored the implementation of monetary policy during 2003. Amid low needs for bank liquidity due to the continuing unoptimal bank intermediation, liquidity supply rose sharply during 2003, due to the expansionary impact of the government's account with Bank Indonesia and the payment of interest on Open Market Operations (OMO).

In these circumstances, the strategy of Open Market Operations was geared to the absorption of excess liquidity with the two main instruments, SBIs and FASBI increased by Rp23.2 trillion in 2003. Efforts to control excess liquidity, especially to limit its use for foreign exchange speculation, was also conducted through regulations on the Net Open Position (NOP). In addition, Bank Indonesia summoned banks on a number of occasions, to stress the importance of minimizing excess liquidity through increased extension of credit.

Notwithstanding the rising cost of monetary control borne by Bank Indonesia, the strategy has maintained base money within target and has kept excess bank liquidity from being used for speculation. On average, the growth rate of base money in 2003 was 10.3%, well below even the adjusted target of 12%. These stable monetary conditions were reflected in the growth rates of both narrow (M1) and broad (M2) money, which were not much different than the pace of expansion of base money, namely 12.4% and 7.7% respectively.

Controlled expansion of money supply and the falling trend of inflation gave Bank Indonesia room to continue signaling lower interest rates. Declines in rates on monetary instruments were followed by lower bank deposit rates at a faster pace. Credit rates also declined but at a far slower rate than deposit rates. The relatively slow pace of decline in credit rates indicated that the transmission of monetary policy through the interest rate channel was less than optimal. However, transmission through the asset price channel was better, as reflected in the improved performance of markets for stocks, bonds, mutual funds (*reksadana*) and property.[9]

8 "To say that inflation is a monetary phenomenon is not to say that excessive monetary expansion is always its sole or principal cause… The monetary nature of every inflation does not imply that it is always easy to disinflation by turning off the monetary spigot" (James Tobin, Nobel Winner in Economics).

9 World Bank and IMF, "Developing Government Bond Market: A Handbook", 2001. Bonds are a better or more cost-effective funding activities for companies with high credit rating when issued at right amount and long-term.

Fiscal Policy

In order to maintain economic recovery after the Bali bombing tragedy, the government attempted to implement a fiscal policy in 2003 that was more expansionary than in preceding years. In doing so, the Government faced two main constraints, namely huge debt repayment obligations and the need to maintain fiscal sustainability. In implementation, the government's financial operations faced several challenges, *inter alia*, low oil production and some delayed policy measures. Amid such constraints and challenges, the implementation of fiscal policy was significantly assisted by conducive monetary conditions that reduced the debt burden and facilitated the management of state finances.

Against this background, the preliminary outcome for the 2003 Budget indicates a deficit of Rp33.7 trillion, equivalent to some 1.9% of GDP, wider than the previous year's deficit of 1.5% of GDP. Notwithstanding this wider deficit, fiscal consolidation was sustained through higher tax revenues, limits on state spending, especially on subsidies, and the gradual reduction of government debt.

The fiscal impact on the real sector is estimated to have been neutral in 2003, meaning that the government's net contribution to economic growth was negligible. In contrast, fiscal policy in the previous year was contractionary. The 2003 stance of fiscal policy and the government decision to limit and suspend price increases on fuel, the basic electricity tariff, and the telephone tariff helped to control inflation in that year.

Along with the wider budget deficit, during the reporting year the government's financial operations in rupiah had a higher net expansionary impact on money in circulation. In contrast, the government's financial operations in foreign exchange led to a smaller net inflow than in 2002. In aggregate, the government's 2003 financial operations were still supportive of fiscal sustainability through the maintenance of primary surplus and a reduction in the debt to GDP ratio. This condition has helped rebuild the confidence of business players in domestic macroeconomic stability.

Microeconomic Policies

Banking Policy

In 2003, Bank Indonesia's banking policy continued along the track undertaken since the onset of the banking crisis. This focused on the bank restructuring program, banking system resilience and a recovery of intermediation.

Within the scope of the bank restructuring program, significant progress was achieved in the reporting year. This included progress in the divestment of the government's shares in Bank Mandiri, BRI, BCA, Bank Niaga, Bank Danamon, and BII. There was also progress in the implementation of credit restructuring. During the period of January – September of 2003, credits in the amount of Rp41.3 trillion were successfully restructured.

Concerning banking resilience, Bank Indonesia continued to develop Rural Credit Banks (*BPRs*) and sharia banking, and to take preparatory measures towards formation of the Deposit Guarantee Agency (LPS). Also, Bank Indonesia continued its efforts to nurture good corporate governance in banking and to improve the regulation and enhancement of supervision with reference to the 25 Basel Core Principles. The efforts to develop BPRs were realized, among others, through the development of a certified training system, the extension of technical assistance, enhanced utilization of information technology and consumer empowerment and protection. Meanwhile, as a part of the implementation phase one of the Blueprint for Development of Shari Banking (which was announced in 2002), improvements were made in some aspects of Sharia banking, including the quality of productive assets; Sharia bank short-term financing facilities; and sharia bank accounting standards. Additionally, in the framework of harmonization of regulations and the adoption of international standards for sharia banking, Bank Indonesia also actively participated in a number of international institutions. One of these was the Islamic Financial Services Board (IFSB) where the Governor of Bank Indonesia was appointed Chairman of the IFSB Council for 2004.

Regarding the recovery of bank intermediation, Bank Indonesia continued to enhance the access of micro, small, and medium sized businesses (UMKM) to bank financing through three approaches, namely bank credit policies, institutional development and the extension of technical aid. In that regard, steps taken include; urging banks to increase the UMKM portion of credits in their business plans; dialog forum and bazaar involving bankers, business players, and the government; and extending technical assistance, formerly limited to banks, to non-bank parties.

Within the framework of supporting financial system stability, Bank Indonesia has established a Financial System Stability (SSK) Bureau and initiated steps to form a Financial Safety Net (FSN). Further, Bank Indonesia has completed the Indonesian Banking Architecture (*API*) as a concept for the future structure of banking industry to be implemented starting 2004. The API program was directed at improving various aspects of the banking industry, such as sound banking structure, effective regulation, independent bank supervision, strong bank internal conditions, adequate supporting infrastructure as well as the protection and empowerment of banking customers.

In general, these various policies, supported by stable macroeconomic conditions, have improved conditions in the national banking system. This is reflected in expanding credit, lower net *NPLs*, higher third party funds, positive net interest income and improved bank capitalization. However, bank intermediation has not yet fully recovered, as evidenced by a sharp increase in undisbursed loans and a continuingly low loan to deposit ratio (LDR). Additionally, there were some developments that warrant attention, *inter alia*: (i) credit risk being still relatively high, especially as indicated by continuing high gross NPLs; (ii) low bank profitability due to slow growth of bank credit, especially credit for the productive business sector; and (iii) low operational efficiency of the major banks and high dependence of banks on bond and SBI interest income.

Payment System Policy

Payment system policy in 2003 continued to simultaneously support monetary policy, enhance prudent management of banks, and reduce systemic risk, which has the potential to disturb financial system stability.

In the area of the **cash payment system**, policies covered three basic areas, namely meeting the public's need for banknotes and coins, ensuring that money in circulation was in good condition, and taking preventive and repressive actions against the circulation of counterfeit money.

To meet the need for banknotes on the part of the public without direct access to banks, Bank Indonesia has developed a pilot project on small cash exchange distribution in cooperation with third parties. Initially, the pilot project was designated for the Jabotabek area. During the reporting year, the service area of the pilot project was extended to 7 Bank Indonesia Branch Offices (*KBI*): Medan, Palembang, Bandung, Semarang, Surabaya, Denpasar, and Makassar.

To obtain metal for coins having intrinsic value less than face value—yet having a relatively long circulation period—a study was made on alternative metal content for rupiah coins and standardization of coin sizes. Based on results of the study, during the reporting year Bank Indonesia issued new, small-denomination coins worth Rp200 and Rp500 made of aluminum.

As regards counterfeiting, preventive measures include: improved money design and greater use of safety features; socialization of the characteristics of authentic rupiah banknotes; and increased coordination with related institutions. Repressive efforts were also taken by way of coordination with related institutions in arresting and bringing to court parties involved in the counterfeiting of rupiah.

In the area of the **non-cash payment system**, Bank Indonesia completed the implementation of Bank Indonesia's Real Time Gross Settlement (BI-RTGS) in all banks and Bank Indonesia Branch Offices in June 2003. BI-RTGS can reduce the risk of transaction settlement failure owing to its capacity to effect transfers in real time and continually during *window time.* This is done under the principle that transfers will be executed only if the balance in the account of the paying bank is sufficient. Using the BI-RTGS system, banks all over Indonesia are able to transfer funds more easily and quickly without having a local clearing (which usually entails delays). In addition, by using interface connected to each bank's internal system, banks are able to forward transfer orders through their regional offices covered by RTGS facility.

During the reporting year, Bank Indonesia prepared the Funds Transfer Bill in observance of the first point of the Core Principles for Systemically Important Payment Systems (CP-SIPS). These regulations are expected to provide more certainty and legal protection to parties related to the activities of fund transfers conducted by banks and non-banks, which are still based on the internal regulations of the respective transfer operators. Relying on CP-SIPS, efficient and effective settlements of transactions by clearing is kept reliable, due to the failure-to-settle arrangement, and Bank Indonesia as the central bank is not necessarily responsible for insufficient bank funds for settling clearing transactions.

In relation to inefficient clearing operations for interbank transfers of funds (which currently still use paper-based credit notes), Bank Indonesia is also developing a paperless credit note *(PNK)*. By this means, interbank transfers can be conducted without paper, that is, in electronic format only.

Investment, Industry, and Trade Policies

In general, and in accordance with the economic development strategy as laid down in the 1999-2004 Broad Outline of the Nation's Direction *(GBHN)*, industry, trade, and investment policies were geared towards the enhancement of global competitiveness. More specifically, in *Propenas* (the National Development Program) 2000-2004, an industrial development strategy was formulated based on the principle of efficiency, supported by improved capacity of human resources and technology for the strengthening of sustained development and national competitiveness. The strategy consisted of development of exports, development of competitively superior industries, reinforcement of market institutions, development of tourism and improvement of scientific and technological capabilities. Relating especially to the development of exports, in the short-term the policy was aimed at reducing procedural constraints and liquidity problems and expanding non-quota export markets. In the medium- to long-term, the policy was directed at improving the quality of export development and infrastructure to support and prepare domestic production and distribution activities for an international system of free trade.

In implementation, the various policies have not produced result as much as expected. The government's proclamation of 2003 as Indonesian Investment Year have yet to significantly boost investment. The business was still confronted with a multitude of problems, such as labor regulations which was not very conducive; overlapping investment and sectoral policies (both interregional and between the central and the regional governments, especially in relation to the implementation of regional autonomy; poor incentives to investors, including tax incentives; security conditions in certain regions; a continuing high-cost economy; and an extremely complicated bureaucracy. Additionally, there was poor development of infrastructure due to constraints on government financing. Other matters demanding prompt attention are legal certainty at various levels, including improved performance of the Commercial Courts and completion of the Capital Investment Bill.

In the production sector, industrial policy has traditionally relied more on comparative advantage, especially cheap labor. But the latest developments indicate that superiority in that regard has been seriously eroded. Consequently, a different approach is needed, oriented more towards the utilization of natural resources and technology-intensive industries in line with the paradigm formulated in *Propenas.*

Policy on Foreign Debt Management and International Cooperation

Various measures regarding foreign debt have been taken to help mitigate the balance of payments burden and to improve the structure of Indonesia's foreign debt. In response, several debt indicators (such as debt-to-export and debt-to-GDP ratios) have declined to a relatively safe level. These developments have increased Indonesian economic resilience vis-à-vis international financial turmoil. Specific measures that have been taken include: government debt restructuring process through the Paris and London Clubs, debt swap agreements, private debt restructuring through Jakarta Initiative Task Force (JITF) and the Exchange Offer Program.

To minimize dependence on short-term foreign debt and to support capital market development in Asia, the central banks in that region, associated in the EMEAP forum, announced on June 2, 2003 the launching of the Asian Bond Fund (ABF). Initially, the amount of funds gathered through ABF1 amounted to $1 billion. Bank Indonesia as a member of EMEAP participated in the amount of $50 million.

In the reporting year, international cooperation included steps to enhance economic resilience in Asia. One of the means was through Bilateral Swap Arrangement (BSA) among the countries of ASEAN+3. Indonesia, represented by Bank Indonesia, in 2003 signed the BSA with the Central Banks of Japan, South Korea, and China with an aggregate amount of $5 billion. This BSA facility is one of the sources for precautionary financing in light of Indonesia's exit from its IMF Program at the end of 2003.

On September 30, 2003, Bank Indonesia officially became a member of the Bank for International Settlement (BIS). Bank Indonesia's membership in BIS is expected to enhance international investors' confidence in Indonesia.

2004 ECONOMIC PROSPECTS

International Economic Prospects

In 2004, more favorable world economic outlook is expected to be shared in various regions, in line with strengthening consumers and business confidence following the easing of geopolitical uncertainties and lower oil prices. Expansionary policies pursued by advanced countries are also expected to boost to world economic growth and trade in 2004. Global economic growth give would be further supported by countries in the Asian region, which are estimated to average more than 6%.

Notwithstanding the acceleration of global economic growth, world inflation is estimated to remain low due to easing pressure from the decline in of oil- and non-oil commodity prices. Inflation is estimated at 3.3% in 2004, slightly lower than that in the preceding year of 3.9%. Inflationary pressure is expected to rise only in 2005. Hence, a number of countries will maintain easy monetary stance at least during the first semester of 2004 before gradually tighten their policies in line with increasing demand and price pressure.

In view of the substantial trade deficit of the US and the unfavorable trade performance of advanced countries in Europe, the authorities in those countries are expected to allow their **exchange rates** to weaken, especially against a number of Asian currencies. By way of example, there are indications of increased pressure exerted by the US and some European countries on China for the latter to implement a more flexible exchange rate policy. If China were to revalue its currency, various currencies in Asia might follow suit, and this might cause an appreciation of the rupiah.

In 2004 **the price of international commodities**, especially non-oil primary commodities and manufactures, is expected to continue rising albeit at a slower pace. This is due in part to the high prices in 2003 motivating producers to increase their output. Increased output would improve the supply thereby slowing down further increase in prices. In particular, oil price is estimated to average $25 per barrel in 2004, down from $31.3 per barrel in 2003 prompted by a gradual return to normal supplies of Iraqi oil; increased production from non-OPEC countries; and new oil reserves in the Caspian Sea, West Africa, and the Western Hemisphere, including the US.

International private capital flows to developing countries are expected to keep increasing in 2004. These will mostly be in the form of foreign direct investment, especially to Latin America, reflecting improving economic, social, and political conditions in that region. However, the major portion of the flows would still be to the Asia-Pacific region of high-yield assets, primarily to China.

Prospects for the Indonesian Balance of Payments

The prospects of rising world trade and increasing non-oil commodity prices will help expand improve Indonesia's non-oil exports in 2004, albeit at a limited pace . This opportunity may not be fully utilized due to the weakening competitiveness of Indonesian non-oil products and heavy reliance on traditional markets. Oil exports are expected to decline due to lower world oil prices. The **current account** is expected to record a surplus of $5.8 billion in 2004, lower than $7.7 billion in the preceding year.

The **deficit on capital account** is forecast to widen in 2004 due to a significantly wider deficit on government account. This is accounted for by an end to rescheduling of sovereign debt through the Paris and London Clubs, following exit from the IMF program. Repayments of private debt, especially by foreign corporations, will also increase. Meanwhile, capital inflows in the form of government debt are predicted to keep increasing, up to $4.1 billion. Increased government debt will partly stem from increased program and project loans and the issuance of foreign exchange bonds. Capital inflows in the form of portfolio investment are expected to continue on an upward trend with the increasing issuance of corporate bonds and the positive interest rates differential. Hence, the **overall balance** will be in deficit and official foreign exchange reserves will decline to $35.1 billion, which is adequate to finance imports and service official foreign debt of 6.3-months.

Rupiah Exchange Rate Prospects

In 2003, the rupiah exchange rate was quite stable with a slightly appreciating trend, which is expected to continue in 2004 within a range of Rp8,200 to Rp8,700 per dollar. Factors supporting the stability of rupiah include conducive macroeconomic conditions; positive expectations following the upgrading of Indonesian debt rating; and the continuing depreciation of US dollar and other world major currencies against Asian currencies.

Despite an anticipated small decline, official foreign exchange reserves will remain sufficient to fill the gap in case of excess demand in domestic foreign exchange market. This will help maintain stability of the rupiah exchange rate. The fact that lower official foreign exchange reserves are partly due to the government's commitment to fiscal consolidation has helped nurture positive sentiment among investors, a factor that helped upgrade government debt rating in 2003. Another factor, that is the general election, is predicted to run smoothly, which will not exert pressure on exchange rate.

Fiscal Prospects

The fiscal burden, is expected to intensify somewhat in 2004, especially on the financing side. The main problems will be the mounting foreign debt repayments post the IMF program; maturity of a considerable amount of domestic debt coming due; and declining amount of salable assets by IBRA. On the positive side, there will be two very helpful factors for the 2004 State Budget, namely the relatively low interest rates and the upgrading of government debt by international rating agencies , which will be favorable for the issuance of domestic and international bonds.

In relation to the post-IMF economic policy of targeting a gradual reduction in budget deficit to a balanced position in the period of 2005-2006, the deficit in 2004 is targeted to narrow significantly relative to 2003. Despite this narrower deficit, the heavy financing burden requires the government to seek new sources of financing, such as issuance of bonds in domestic and international markets. However, this amount is expected to be insufficient, and the government will again have to drawdown its savings in considerable amount. By contrast, government policy is estimated to be supportive of controlling inflation in 2004 since there are no plans to increase administered prices, for example, raising the retail prices of electric power, fuel and goods subject to excise taxes.

On this basis, the impact of fiscal policy on aggregate demand in 2004 is estimated to be contractionary relative to 2003. The fiscal deficit in 2004 will reach 1.2% of GDP, considerably narrower than the 2003 deficit of 1.9% of GDP largely due to lower government investment and transfer payments. With a contractionary fiscal impact on the real sector and supportive pricing policies, the government sector is estimated to exert no significant pressure on aggregate demand and on inflation in 2004, the same as in 2003. On the monetary side, the net expansionary impact of the rupiah component of the State Budget on money supply will be far smaller than that in 2003. However, the monetary impact in foreign exchange would for the first time create a net foreign exchange outflow in line with lower oil revenue and net outflows due to amortization of external debt. As was the case in 2003, the government's financial condition in 2004 is estimated to be consistent with fiscal sustainability as reflected in a continuing surplus on primary balance and the steady declines in the government debt to GDP ratio.

Economic Growth Prospects

Relatively stable developments in various macroeconomic indicators in 2003 are expected to continue in 2004, supported by conducive socio-political-security conditions. These positive developments have helped rebuild public confidence (domestic and international) in Indonesia's economic prospects. Observing these various developments, economic growth in 2004 is estimated to reach 4% - 5%.

On **the demand side**, consumption expenditure is predicted to continue growing considerably. Exports and investment would also improve, albeit at a low level of growth. Relatively strong growth of private consumption would be supported, among others, by the positive impact of stable inflation on the public's purchasing power. Also, relatively low interest rates would give a boost from the financing side. Meanwhile, government consumption is predicted to record a high growth, albeit at slower rate than in the preceding year.

Investment, especially private investment, is also predicted to expand along with improved business optimism concerning the prospects for overall economic growth and gradual recovery of the real sector. It would be further supported by government investment in productive sectors and improvement of some infrastructure and public utilities. From the financing side, investment spending would be financed by bond issuance, extensions of bank credit and self-financing. From domestic sources, new credit from banks is forecast to increase in 2004, following strengthened corporate balance sheets in the wake of corporate debt restructuring. From foreign sources, better economic prospects would prompt investors to shift some of their capital to Indonesia. However, in the near-term, investment is forecast to grow only moderately in light of existing, underutilized capacity. Industrial sectors supportive of private investment include sub-sectors with a rapidly developing domestic market, such as telecommunications and electricity, and extractive natural resource based industries.

In 2004, exports would be boosted by rising economic growth in Indonesia's main trading partners in the European and American regions. Also, world prices of some non-oil/gas export commodities—especially minerals and manufactures, which had been relatively stable—are forecast to rise, thereby inducing business players to increase exports. Nonetheless, export growth is forecast to remain relatively subdued, due to low competitiveness of Indonesian products in the face of tough competition in international markets. Meanwhile, import growth is forecast to rise in line with improved domestic demand and exports. Rising imports are also driven by increased penetration of low-price import products from China.

From the **supply side**, 2004 economic growth would be supported by all economic sectors with the main contributors being manufacturing, transportation and communications, trade, hotels and restaurants. Meanwhile, improved expectations of economic growth as reflected in the Consumer Confidence Survey would add to activities on the production side. The General Election would also increase growth in some sectors, namely retail trade, manufacturing, transportation, communications and general administrative services. The construction sector would get a boost from a number of development projects in the areas of property, manufacturing, regional infrastructure, water resources, electricity, telecommunications as well as natural gas mining.

Inflation Prospects

Inflation is expected to continue declining due to improvements in various factors, including: the stable exchange rate; relative balance between aggregate demand and supply; and lowered pressure from administered prices, all of which would improve expectations. Reflecting these factors, core inflation would decline a bit in 2004 and 2005, to 6.9% and 6.2%.[10] However, in the short-term there would still be some pressure on inflation deriving from foodstuffs and administered price in 2005, and thereby would push up CPI to 5.5% and 6% in 2004 and 2005 respectively, as compare to declining core inflation.

The price of foodstuffs, which tend to be volatile, are expected to rise slightly in 2004 and 2005, after a sharp decline in 2003. This higher forecast is based mainly on foodstuff production, which in the last few years has increased by less than population growth, and relative price adjustments between food and non-food. The latter being continuously increasing. However, the impact of these increases would be limited by adequate amounts of imports in those two years. Meanwhile, administered prices are forecast to increase appreciably in 2005 after being

10 Core inflation is calculated with exclusion method, i.e. by excluding permanently a number of goods which price formation mechanism are distorted, such as administered price and volatile food price.

suspended in 2003 and 2004, especially fuel, telephone tariffs and basic electricity tariff.

Banking Prospects

The banking sector is forecast to strengthen in 2004. In line with rising GDP, third party funds and bank credit are forecast to grow in the ranges of 6-10% and 15-20% respectively. These increased bank intermediation activities would be accompanied by improved quality of credit, profitability, and bank solvency.

This forecast of rising third party funds is in line with the results of the public confidence survey towards the banking sector, which improved in 2003. By composition, savings accounts would increase most, related to public preferences for short-term deposits due to the thin spread between interest rates on deposits and savings. Meanwhile, credit extensions would be supported by improved business activity and private consumption in 2004. Consumer credit would lead the way, in line with the continuing dominant consumption as the main impetus for economic growth.

Business activities of sharia banks are also forecast to increase. Supportive policies, socialization and education programs for the public are positive factors for the fund raising and financing by sharia banks. Continued rapid growth in sharia banks would allow these banks' market share to exceed 1% of total assets in the banking sector.

Improving condition of the banks would be favorable to the privatization program in 2004. So far the privatization program has contributed to the improved performance of national banking through improved transparency, good corporate governance, and the transfer of expertise, knowledge, and technology. Some of these have considerably helped to improve market discipline and thereby improving the effectiveness of bank supervision as well.

Although bank intermediation is expected to improve, the main challenge for banks will be tough competition with other players in the financial market in the face of on-going corporate restructuring. In that context, banks will be forced to improve their efficiency and increase their productive assets through greater extensions of credit, which is their main function.

Banking will also be confronted with other problems, including the risk of deteriorating quality of restructured credits and pressure on profitability due to lower income from recapitalization bonds and SBIs. In addition, the plan to gradually eliminate the guarantee program could trigger the transfer of third party funds from small banks to big banks or to state-owned banks. Moreover, non-performing loans (NPLs) are forecast to rise due to end of the performing loans classification on credits purchased from IBRA.

DIRECTION AND STRATEGY OF POLICY IN 2004

Monetary Policy Direction

Taking into account economic prospects and various anticipated problems, especially of banks, Bank Indonesia's monetary policy in 2004 will continue to be directed at achieving the medium-term inflation target of 6% in 2006. To that end, Bank Indonesia will supply liquidity in accordance with economic needs by growth of base money in the range of 13% - 14.5%. In addition to maintain stability in financial markets, Bank Indonesia will continue to use interest rates as a signal of monetary policy.

In implementing this policy, Bank Indonesia mainly uses OMO, with SBIs continuing as the principal instrument. Additionally, Bank Indonesia will strive to utilize Government Securities *(SUN)* and other alternative instruments. Additionally, Bank Indonesia will continue to urge the utilization of excess liquidity through bank credit expansion as a means to finance business activities.

Concerning the exchange rate, Bank Indonesia policy continues to be geared towards suppressing volatility in exchange rate movements within the framework of attaining the medium-term inflation target. This is expected to reduce uncertainty, thereby heightening public confidence in macroeconomic stability and assisting the business community in making business and investment decisions.

In response to the negative impact of potential capital flows reversal that might disrupt rupiah stability, Bank Indonesia will use various policy options to anticipate such turmoil, for example through enforcement of bank compliance with various prudential regulations related to foreign exchange activities; improvement of PBI No. 3/3/2001; and strengthening the capacity to monitor the foreign exchange movement.

Banking Policy Direction

Within the context of rebuilding intermediation, banking development policy will be rooted with a vision to attain a sound and efficient banking system necessary to create financial system stability in order to boost national economic growth. Such a vision was articulated in the API program, which was announced at the beginning of 2004. API continues the series of banking sector policies undertaken after the financial crisis of 1997/98.

API has a vision that within a period of ten to fifteen years, the national banking structure will consist of a few international scale banks, several national scale banks and specialized banks dealing solely in certain business activities. Additionally, the envisaged national banking system will still be bolstered by *BPR*s (Rural Credit Banks) and banks with limited business activities.

To achieve this vision, API has 6 staged-implementation programs delineated along several activity plans. The six programs will be realized in stages from 2004 to 2013. Some of the activities are expected to be executed in 2004 and to have an immediate impact on the national banking system. The first is a consumer protection program, which would help rebuild public confidence and trust in the national banking system. The second is a risk management certification program that would reduce potential risks faced by banks. The third is the establishment of a banking expert panel whose duty is to provide suggestions and strategic direction on regulatory policies needed for the improvement of banking performance.

By way of anticipating potential risks, Bank Indonesia continues to encourage the application of better risk management through improved regulations with reference to the 25 Basel Core Principles. In line therewith, Bank Indonesia's supervisory approach will be adjusted to emphasize risk management. In implementation, this approach requires such specific expertise of bank supervisors and auditors that on-going training is required as indicated by the Second Pillar of the Basel II document, namely Supervisory Review Process.

Assessment results of this more risk-oriented bank supervision will then be amalgamated in a new CAMEL system with the addition of components sensitive to market risk, such that it will then be called CAMELS. Additionally, each element of the CAMELS will be redefined to include new variables that are considered suitable. The CAMELS valuation system will be introduced on an experimental basis in 2004, prior to its formal adoption in 2005.

With the end of IBRA's mandate in February 2004, Bank Indonesia plans to revise PBI No. 3/25/PBI/2001 dated December 26, 2001 on the Assignment of Banks' Status and Delivery of Banks to IBRA.

By way of anticipating a fast development of sharia banking, regulations will be issued in 2004 concerning, *inter alia*, institutional aspects of sharia bank; standard on commitments; standard on capital adequacy requirements; risk-based supervision; and risk management guidelines. Additionally, in relation to Preparation of Statement of Financial Accounting Standards (PSAK) No. 59 and Indonesia Sharia Banking Accounting Guidelines (PAPSI), regulations will be prepared on transparency of financial conditions and monthly reporting by sharia BPRs.

Regarding attempts to boost bank intermediation by improving and expanding bank sector services in Micro, Small and Medium Business *(UMKM)*, Bank Indonesia will apply several policies, *inter alia*: the extension of technical assistance for training and the provision of information on banking and the real sector; research on small business finance in some provinces in eastern Indonesia; socialization activities; and soliciting the government to facilitate legal instruments for credit collateral. Moreover, within the framework of financing through Government Securities (SUP), Bank Indonesia will continue to help the government so far as permitted under the Act on Bank Indonesia.

Payment System Policy Direction

In the area of the **cash payment system**, attempts will continue to improve the efficiency of money circulation by meeting the public need for banknotes and coins. This is done, *inter alia*, through attempts to meet public needs for small denomination banknotes and accelerated withdrawal of worn and damaged notes. Efforts to control the counterfeiting money both preventively and repressively through law enforcement will be continued in cooperation with the Police and through widening of networks.

In the area of the **non-cash payment system**, policy will continue to be directed towards organizing and maintaining smooth operations of the payment system for the creation of an efficient, quick, safe, and reliable national payment system in support of stability in the monetary and financial system. The specific targets are minimized risk in the payment system, improved efficiency and reliability within the payment system, and the provision of consumer protection for payment system users. To that end, in 2004 several actions will be taken, namely: submission and discussion with the legislative body concerning the Funds Transfer Bill; the development of paperless credit notes; reviewing the national payment system blueprint; preparation of a failure-to-settle scheme; a study on efforts to expand BPRs' role in the payment system; and the preparation of an academic draft on the payment system supervisory strategy.

Risks and Uncertainties

Notwithstanding improved macroeconomic prospects in 2004, the Indonesian economy is still confronted with various risks and uncertainties, both internally and externally. If such factors can be overcome, macroeconomic prospects will be better than forecast. Conversely, if they cannot be overcome, macroeconomic prospects will tend to worsen.

Some of the risks and uncertainties are:

- Political transition at a time when Indonesia has just exited the IMF program may lead to uncertainty about the continuity of the economic restructuring program.
- Public perceptions on law enforcement and security are not yet conducive to growth.
- Prospects for global economic recovery are still highly uncertain.
- Higher interest rates in developed countries, especially the US, could limit capital inflows to Indonesia.
- International competition could become more intense at a time when the competitiveness of Indonesian products is tending to weaken.

Chapter 2: Macroeconomic Conditions

Chapter 2: Macroeconomic Conditions

Indonesia's economy grew by 4.1% in 2003, higher than the previous year. From the demand side, the economic growth was attributable more to consumption than to investment and exports, which expanded very slowly. From the supply side, despite its low growth, the manufacturing sector still performed as the largest contributor to economic growth. In the face of moderate economic growth, unemployment swelled by 11.3% over the previous year. Meanwhile, the level of public welfare as reflected in per capita income remained below its pre-crisis level.

The economic performance had consistently recovered along with improvement of several macroeconomic indicators such as declining inflation rate, decreasing interest rates, and strengthening rupiah exchange rate. The economy grew by 4.1%, higher than the previous year's 3.7%. This growth was insufficient to significantly improve public welfare as indicated, for instance, by per capita income[1], which remained below the pre-crisis levels (Rp2.0 million in 2003 versus Rp2.2 million in 1997; see Box: *Economic Growth and Social Welfare*).

On the demand side, all major components expanded, with consumption remaining the mainstay of economic growth. Low inflation rate in the reporting year led to higher real disposable income, while lower interest rates boosted consumer financing. For their part, investment and exports picked up in 2003, although their role in raising economic growth remained lackluster. Despite its low growth, investment has shown improved efficiency, as measured by Indonesia's ICOR.

On the supply side, all economic sectors expanded in line with rising aggregate demand. There were, however, some problems. Most notably, manufacturing, which accounts for the largest share of GDP, continued to expand at the rate below the pre-crisis period. This indicates an unpromising foundation for sustained economic growth, because manufacturing has substantial backward-forward linkages with other sectors.[2] As a consequence, the wide gap between domestic demand and domestic production had to be met by imports.

The main problems on the production side were due to various problems inhibiting business environment such as financing, competitiveness and external problems. Financing remained limited due to banking risk perception on domestic corporations which is persistently high and by incomplete corporate debt restructuring. Poor international competitiveness was partly due to higher costs of production that paved the way for imported products to substitute domestic products. On the external side, problems stemmed from lower world trade and rising number of low-cost competitors.

The important outcome of such economic structure was the inability of the economy to absorb new

1 1993 constant price per capita income

2 A simulation using Input-Output Model concluded that, the increase in the final demand for manufacturing sector creates the highest GDP growth, compare to the same increase of other sectors' final demand. (Idris, Rendra Z, *Decreasing Interest Rate, Economic Growth and Disinflation Process*, Research Note, Bank Indonesia, March 2003)

entrants to the labor force. The number of unemployed soared to 10.1 million people in 2003, up by 11.3% over the previous year.

AGGREGATE DEMAND

Economic growth was 4.1% in 2003, up from 3.7% in the previous year. All major components of aggregate demand expanded, which makes for a somewhat broader base for economic growth (Table 2.1). Consumption remained the main contributor to growth; investment and exports increased but still played an insignificant role as the engine of growth.

Consumption responded to improved macroeconomic indicators such as falling interest rates and declining inflation. However, investment, which has larger multiplier than consumption, barely increased despite lower interest rates. This was due to some extended structural problems that continue to sour the investment climate. For their part, exports encountered domestic production problems and sluggish world demand.

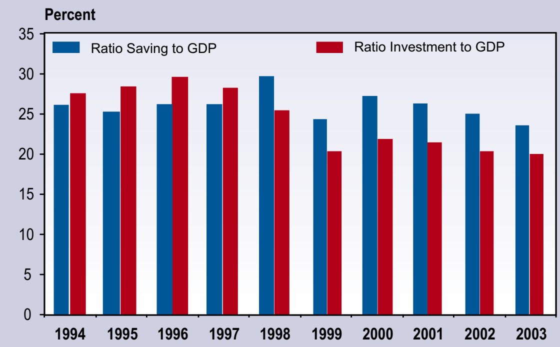
In the reporting year, **private consumption** grew by 4.0%, higher than that of the previous year. Some indicators confirming increased private consumption include the declining savings to income ratio, increasing retail survey index, rising sales of vans, sedan and motorcycle, and mounting imports of consumption goods. Factors encouraging private consumption growth were increased real income, improved public confidence and increased availability of consumer financing.

Table 2.1.
Gross Domestic Product by Expenditures

(Percent)

Component	Average 1989-1997	2000	2001	2002*	2003**
Growth					
Total Consumption	8.2	2.0	3.9	4.7	4.6
Private	8.9	1.6	3.4	3.8	4.0
Goverment	3.6	6.5	9.0	12.8	9.8
Investment [1]	11.7	16.7	6.5	0.2	1.4
Exports and Services	9.1	26.5	2.9	-0.6	4.0
Imports and Services	14.0	25.9	8.2	-5.0	2.0
GDP	**7.8**	**4.9**	**3.5**	**3.7**	**4.1**
Contribution to Growth					
Total Consumption	5.5	1.6	3.0	3.6	3.6
Private	5.2	1.1	2.3	2.6	2.8
Goverment	0.4	0.5	0.7	1.0	0.8
Investment [1]	3.1	3.4	1.5	0.1	0.3
Exports and Services	2.3	6.4	0.9	-0.2	1.1
Imports and Services	3.4	5.4	2.0	-1.3	0.5

1) Investment is gross domestic fixed
Source : BPS-Statistic Indonesia, Processed



Sources : BPS-Statistic Indonesia, BI, Ministry of Finance, Processed

Chart 2.1
Ratio Saving and Investment to GDP

Savings-to-income ratio declined slightly implying that the consumed portion of income increased (Chart 2.1). Likewise, the overall Retail Sales Real Index in 2003 increased, supported by almost all components (Chart 2.2). Declines occurred only in vehicle spare parts, handicrafts, art and toys. Reflecting the impact of continuing interest rate declines, consumption of durable goods increased. In

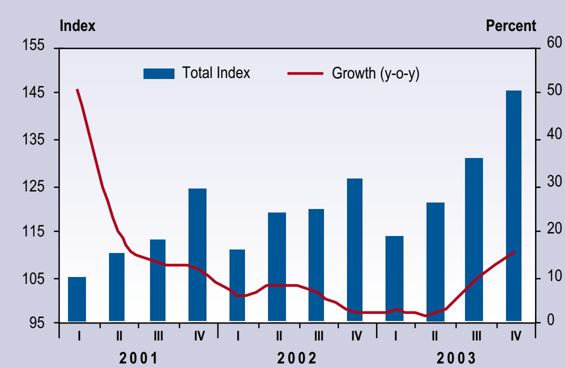
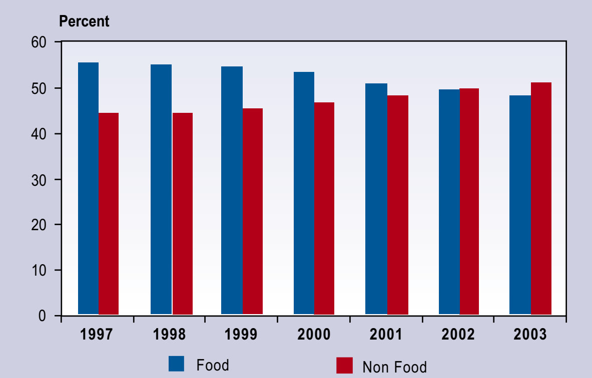


Chart 2.2
Retail Sales Real Index



Source : BPS-Statistic Indonesia

Chart 2.3
Ratio Food and Non-Food to Private Consumption Expenditures

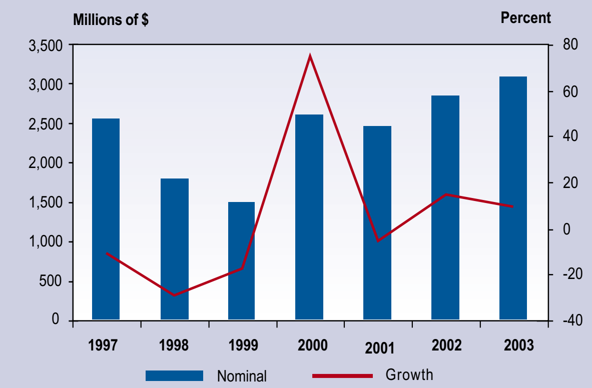


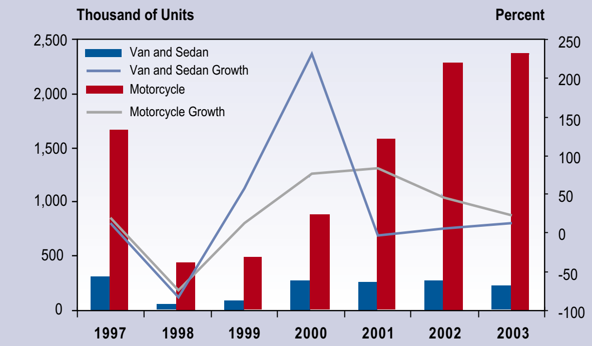
Chart 2.5
Import Value of Consumption Goods

fact, since 2002 consumption of durable goods had exceeded consumption of foodstuffs (Chart 2.3). Another indicator that confirm increasing consumption are increasing sales of vans, sedans and motorcycles (Chart 2.4). Meanwhile, imports of consumption goods continued to expand in 2003, albeit at a slower pace (Chart 2.5). The slowdown occurred in nearly all categories of goods, except passenger cars.

Growth in private consumption in 2003 was further supported by stronger consumer sentiment. The Consumer Confidence Index tended to improve due to the improvement in both current economic conditions index and the consumer expectations index (Chart 2.6). Improvement in the former stemmed, *inter alia*, from consumer optimism concerning their incomes and optimism regarding consuming durable goods (Chart 2.7).

This increased consumption was backed by growing disposable income. It is noteworthy, the growth of disposable income tend to slow down due to increased taxation as reflected in the increased ratio of tax revenue in the State Budget for 2003. Notwithstanding higher taxation, lower inflation in the reporting year helped sustain disposable real incomes as did increase in provincial minimum wages and civil servant salaries (Chart 2.8).

Growth in consumption was further supported by the availability of financing scheme, related to persistent decline in interest rate. At one side, Banks' perceptions of relatively low risk boosted consumer credit, though the



Source : CEIC data

Chart 2.4
Van-Sedan and Motorcycle Sales

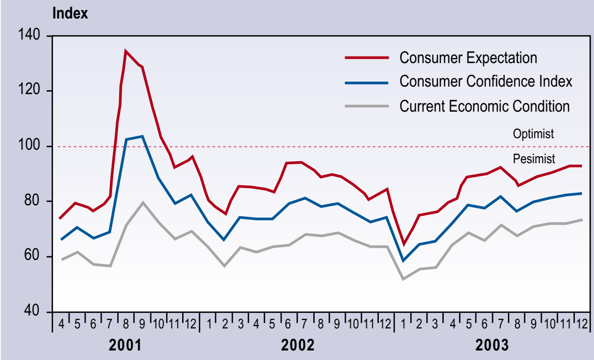


Chart 2.6
Consumer Confidence Index

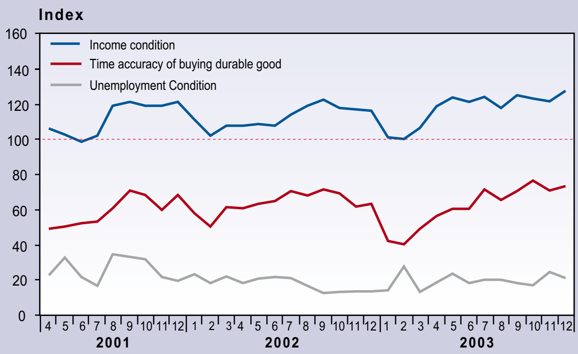


Chart 2.7
Component of Current Condition Index

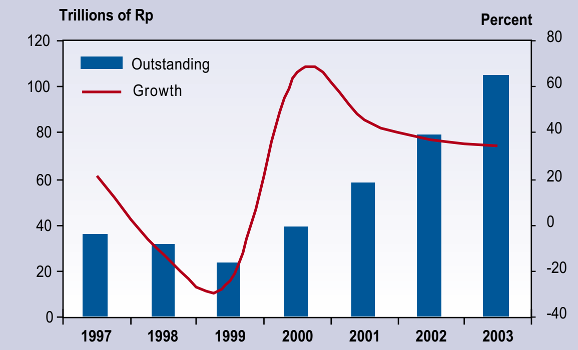


Chart 2.9
Credit Consumption

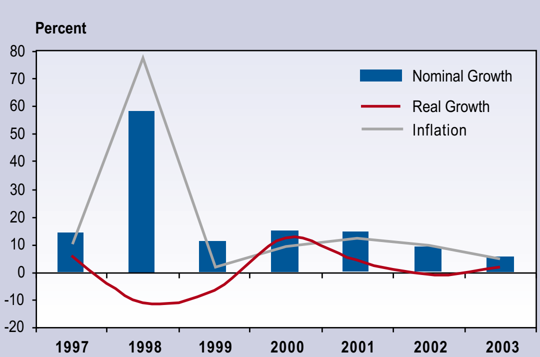
pace of expansion did decline (Chart 2.9). At the other side, consumer financing from finance companies also expanded, supported by a growing number of bond-issuing companies in the domestic market (Chart 2.10).

In 2003, **government consumption** expanded rapidly, in line with rising budget allocation from 7.3% of GDP in 2002 to 8.4% in 2003. Most was in the form of general allocation funds and domestic personnel expenditure. This increased government consumption was financed by increased in both tax and non-tax revenue.

Investment in 2003 grew by 1.4%, up from the previous year's 0.2%. An increase was evidenced by higher imports of capital goods, increased truck sales, and increased foreign and domestic investment approvals. However, the role played by investment in economic recovery was still very limited as indicated by a level of growth that was way below pre-crisis rates of some 12% annually, owing to unfavorable business environment.

Essentially, the government has launched several policies to boost investment. The government named 2003 as Indonesian Investment Year with one of the government's programs being to improve various investment-related laws. In this context, the Government also established a National Team for Investment Protection, which was supposed to facilitate settlement of a host of investment issues, including regulations and other hurdles encountered by investors[3]. Moreover, the government

3 Report of Head of Investment Coordinating Body, 27 February 2003.



Sources : BPS-Statistic Indonesia, Ministry of Finance, Processed

Chart 2.8
Disposable Income

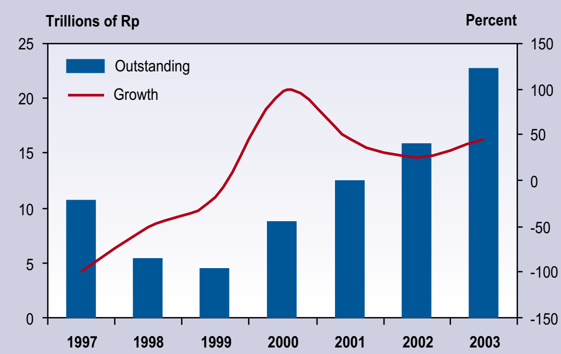


Chart 2.10
Consumer Financing

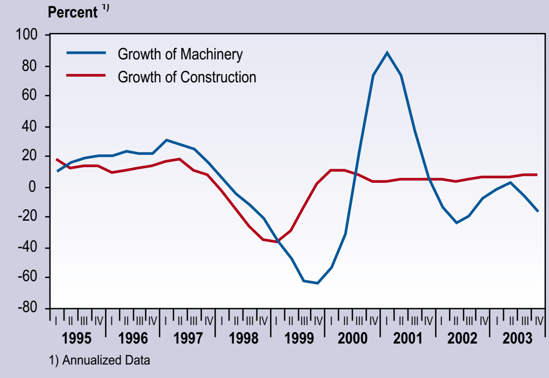
planned to establish a "one-roof" service for investment licensing.

Nevertheless, these programs yielded no significant improvement in the investment climate. A multitude of factors hindered investment, to mention only a few: (i) lack of legal certainty; (ii) overlapping government regulations and laws; and (iii) ongoing security disturbances in certain regions. As a result, these unfavorable conditions affected Indonesia's overall competitiveness.

Unfavorable labor laws further aggravated competitiveness as did legal uncertainty, which requires corrective action, including clarification and empowerment of the Commercial Courts and finalization of the Investment Bill. The problem of overlapping government regulations was aggravated among others by the implementation of regional autonomy since 2001. For the regional governments, regional autonomy has been an opportunity to receive a larger and fairer portion of financing and to extend their tax bases. These policies have created uncertainty for business, including from the lack of clarity in legislative authority and from the new regional revenue sources. These have led to overlapping regulations issued by the central and regional governments. According to the Regional Autonomy Implementation Monitoring Committee (KPPOD), approximately 32,0% of 896 regional regulations surveyed have the potential to disrupt business activity.[4] This is an indication that regional autonomy still poses a serious problem and eventually will turn into a barrier to investment. Meanwhile, security disturbances in some conflict-prone regions (such as Nangroe Aceh Darussalam, Poso, Papua, and Ambon) further discouraged investment in those regions.

A related negative development concerning investment in manufacturing appeared to remain weak. This is reflected in, among others, declining investment in machinery and equipment (Chart 2.11).

4 Press release of Coordinating Minister for Economic Affairs, 26 January 2003.



Source : BPS-Statistic Indonesia, Processed

Chart 2.11
Investment Component Growth

Consequently, the above progress creates challenge to Indonesia's competitiveness. Low competitiveness was indicated in some surveys, for example, the Indonesian Growth Competitiveness Index ranked the nation 72nd among 102 countries. This position is a poor performance relative to competitor-countries in Asia. As regard the Business Competitiveness Index, Indonesia ranked the 60th among 101 countries, topping only the Philippines among competitor-countries in Asia.

Nonetheless, there are a few encouraging indications concerning investment. For instance, the value of imports of capital goods rose by 9.1% in 2003, compared with a decline of 5.0% in 2002. This increased import of capital goods especially came in the form of electronic equipment and generators, and train equipment, ships, and airplanes.

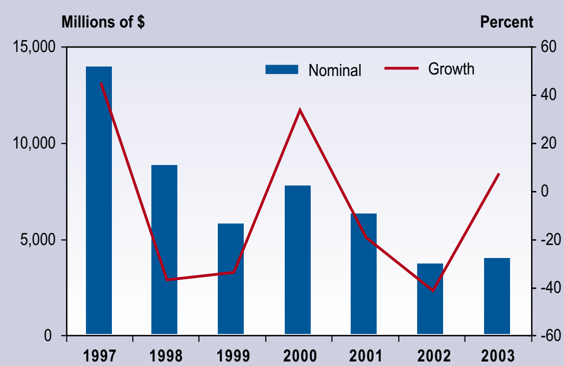
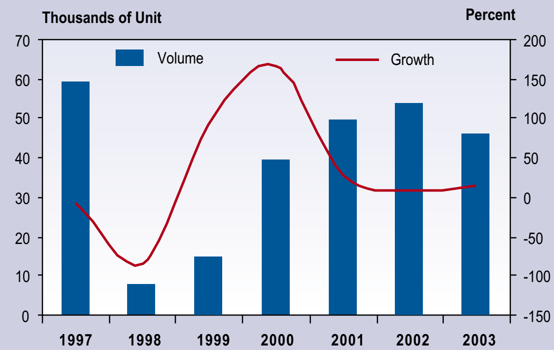
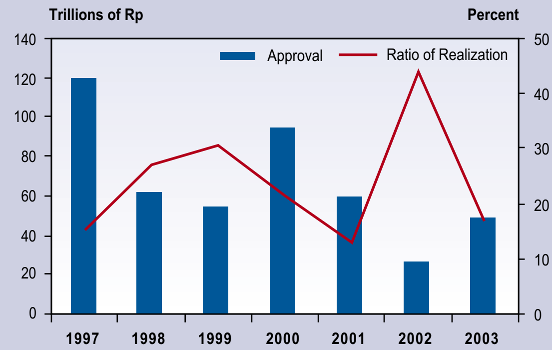


Chart 2.12
Capital Goods Imports



Source : CEIC Data

Chart 2.13
Truck Sales



Source : BKPM

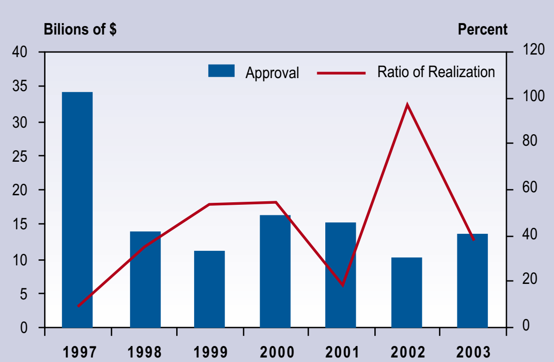
Chart 2.15
Domestic Investment Approval and Realization

In addition, cumulative sales of trucks through November 2003 increased by 5.9% (Chart 2.13).

Further, the value of foreign (PMA) and domestic (PMDN) direct investment approvals increased in 2003. The value of approval for new projects increased while investment for expansion decreased. It is worth noted that the realized percentage[5] of PMA and PMDN (compared with the value of approvals) in 2003 was lower than in 2002, 37.7% and 16.9% versus 97.7% and 43.7% respectively (Chart 2.14 and 2.15). This suggested that investors' interest has begun to arise, but they are still being very cautious.

The increase in investment in 2003 stemmed from two main factors, namely the availability of investment financing and improved sentiment of business players. In fact, the potential for domestic financing was still quite substantial, as suggested by the remaining high ratio of savings to investment, although it did taper-off (Table 2.2). This was due to a wider government deficit and a narrower

5 Realized percentage is the ratio of Permanent Business License value issued by Investment Coordinating Body to the approved investment value for the same year.



Source : BKPM

Chart 2.14
Foreign Investment Approval and Realization

Table 2.2
Saving - Investment Gap

	2001	2002	2003
	Current Price (Trillions of Rp)		
Government			
Saving	31.1	48.7	73.7
Investment	71.6	72.2	107.3
Deficit/Surplus	-40.5	-23.6	-33.7
Private			
Saving	355.9	349.6	345.8
Investment	244.6	253.1	246.1
Deficit/Surplus	111.3	96.4	99.8
Total			
Saving	386.9	398.2	419.5
Investment	316.2	325.3	353.4
Deficit/Surplus	70.8	72.9	66.1
	Ratio to GDP (%)		
Goverrnment			
Saving	2.1	3.0	4.1
Investment	4.9	4.5	6.0
Deficit/Surplus	-2.8	-1.5	-1.9
Private			
Saving	24.2	21.7	19.4
Investment	16.7	15.7	13.8
Deficit/Surplus	7.6	6.0	5.6
Total			
Saving	26.4	24.7	23.5
Investment	21.5	20.2	19.8
Deficit/Surplus	4.8	4.5	3.7
Notes:			
GDP (Trillions of Rp)	1,467.7	1,610.6	1,786.7
Current Account (Millions of $)	6,901	7,822	7,709
Average Exchange Rate (Rp/$)	10,255	9,318	8,572

Sources : BPS-Statistic Indonesia, Ministry of Finance, BI, processed private sector surplus. Despite relatively large domestic financing, actual investment spending was very limited, indeed, a far cry from that in the pre-crisis period when investment averaged some 12.0% per year. Limited investment was due to inhibiting factors discussed earlier.

In addition, issuance of bonds as an alternative source of investment financing did increased in 2003. The value of newly issued bonds (based on effective statement of corporations registered with the Investment Market Supervisory Board (Bapepam)) reached Rp25.7 trillion in 2003, an increase of 300.0% compared with year 2002's 114.0%. The upward trend of bond issuance in domestic markets in the last two years was probably due to two factors. Firstly, domestic banks still perceived domestic corporations as high risk. And, secondly, domestic corporations were still in the debt restructuring process, making it more advantageous for them to seek alternative financing through the stock market. However, this considerable amount of financing in capital markets appears to have been for corporate restructuring rather than for business expansion.

Nonetheless, as interest rates declined, investment credit increased relative to the previous year. Notably, credit increased to the property sector, giving construction investment a boost in the formation of GDP in 2003 (Chart 2.16).

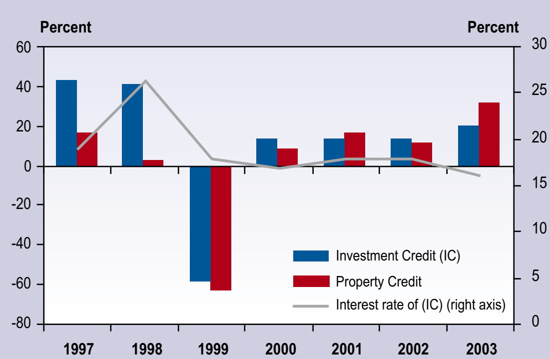
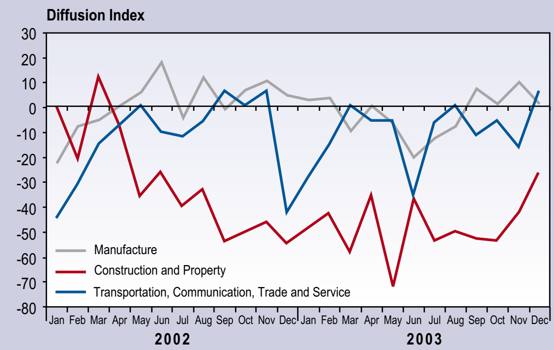


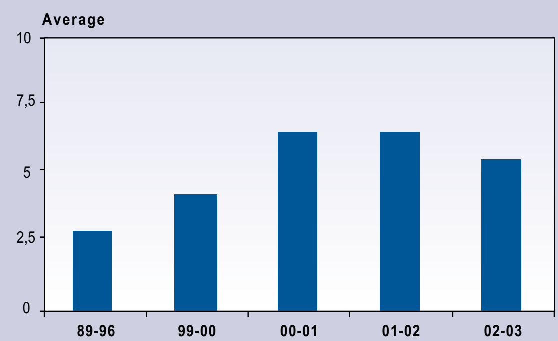
Chart 2.16
Investment and Property Credit Growth



Source : JETRO

Chart 2.17
Business Sentiment Growth

Increased investment was also due to improved sentiment among both foreign and domestic business players. In particular, business sentiment among Japanese entrepreneurs showed an upward trend during 2003. Improved business sentiment was concentrated outside manufacturing, namely in construction, transportation, and communication sectors (Chart 2.17). Domestic business players' perception , collected from Business Survey, on domestic business conditions indicated an optimism throughout 2003. Therefore, this optimism encouraged respondents to invest significantly. The value of investment realization increased significantly especially in the first semester of 2003, while in second half of 2003 its value was relatively stable compared to that of in semester II-2003. The planned investments were aimed



Source : BPS-Statistic Indonesia, Processed

Chart 2.18
Incremental Capital-Output Ratio (ICOR)

especially at business expansion and replacement. The upward trend of investment was accompanied by improved efficiency of investment as reflected in a lower ICOR (meaning that the production of one unit of output needed less investment than that in the previous year). This year's ICOR, however, is still higher that in the pre-crisis period (Chart 2.18).

Exports of goods and services increased by 4.0% in the reporting year. This rate is still far below the pre-crisis average rate of 9% per year. Similarly, **imports of goods and services** expanded in the reporting year, in line with increases in domestic demand and exports.[6]

AGGREGATE SUPPLY

Following the increasing trend in the last two years, GDP grew higher in 2003 compare to that of 2002. However, this development did not suggest a promising foundation for sustained growth, due to the fact that manufacturing sector, which has the largest backward-forward linkages, was still lackluster. Likewise, the growth of other sectors, except for Transportation and Communications, was far below the pre-crisis averages (Table 2.3).

Nonetheless, the continuing upward trend in growth since 2001 has provided the economic recovery with good momentum. Several factors accounted for this continuing rise in growth, among others are a strong commitment by the authorities to reduce inflation, to maintain foreign exchange stability and to enforce fiscal discipline; progress in corporate debt restructuring that improved the financial health and confidence in domestic corporations; and the ongoing privatization process that enhanced production efficiency, by way of transforming the state/regional-owned companies (BUMN/BUMD) into profit-oriented private companies.

6 See Chapter 6 Balance of Payment

Table 2.3
Sectoral GDP Growth

(Percent)

	Average 1989-1997	2000	2001	2002*	2003**
Growth					
Agriculture	3.1	1.9	1.7	2.0	2.5
Mining and Quarrying	5.8	5.5	1.3	2.5	0.5
Manufacture	10.6	6.0	3.1	3.4	3.5
Electricity, Water and Gas	12.9	7.6	8.2	6.0	6.8
Construction	13.3	5.6	4.4	4.9	6.7
Trade, Hotel & Restaurant	9.0	5.7	3.7	3.8	3.7
Transportation & Communication	8.5	8.6	7.8	8.0	10.7
Finance. Rental & Service	10.7	4.6	5.4	5.7	6.3
Services	3.7	2.3	3.1	2.1	3.4
GDP	**7.8**	**4.9**	**3.5**	**3.7**	**4.1**
Contribution to Growth					
Agriculture	0.6	0.3	0.3	0.3	0.4
Mining and Quarrying	0.6	0.5	0.1	0.2	0.0
Manufacture	2.3	1.6	0.8	0.9	0.9
Electricity, Water and Gas	0.1	0.1	0.1	0.1	0.1
Construction	0.9	0.3	0.3	0.3	0.4
Trade, Hotel & Restaurant	1.5	0.9	0.6	0.6	0.6
Transportation & Communication	0.6	0.6	0.6	0.6	0.9
Finance, Rental & Service	0.9	0.3	0.4	0.4	0.5
Services	0.4	0.2	0.3	0.2	0.3
GDP	**7.8**	**4.9**	**3.5**	**3.7**	**4.1**

Source : BPS, processed

Unfortunately, this momentum was not utilized optimally. On the production side, the raise in production cost due to problems in financing and government policies, made higher growth not viable. This low growth of the industrial sector meant that increased consumption demand could not be completely met by domestic production. The resulting gap was filled by imports as suggested by higher imports of consumer goods. Further, the modest growth of the industrial sector was also exaggerated by low competitiveness of Indonesian products. A contributor in this regard was the lack of an integrated industrial strategy and policies to create a highly competitive domestic industry. Without such a strategy and appropriate industrial policies, it will be difficult to achieve significant growth in this sector.

Common business problems included limited financing, low competitiveness versus foreign producers, rising production costs and resulting weak demand for exports. Financing problems were resulted from limited

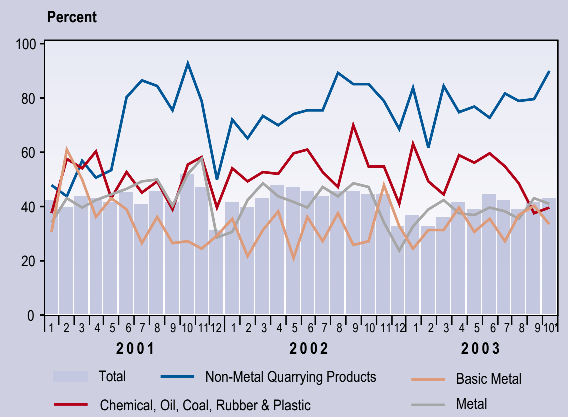


Chart 2.19
Used Capacity

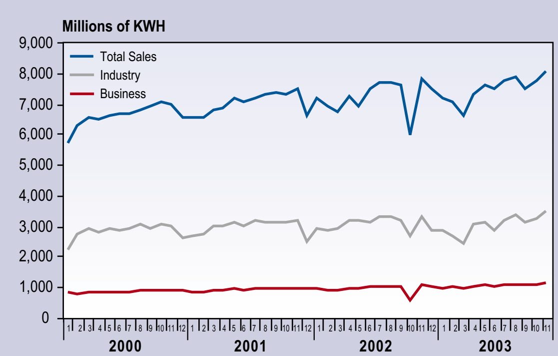
extensions of banks credit as they continued to view local business as high-risk and they tried to maintain profits. This explains why credit interest rates declined only slightly, despite significant lower Bank Indonesia's policy rates. Indeed, lower SBI rate have led to the emergence of alternative sources of financing by corporations, namely bonds. However, the number of eligible corporation that have the luxury of issuing bonds was quite limited, causing lack of financing to remain as a major obstacle to higher growth.

The relatively low growth of manufacturing was mirrored by low rate of capacity utilization (Chart 2.19). It should be noted that, despite the low overall rate of capacity utilization, the variation among industries was quite high; some industries were operating at nearly full capacity, while those of others were still very low. Hence, the financing needs were not only in the form of working capital financing but also of investment financing.

With regard to industries with low utilization, poor competitiveness entails bleak prospect. Poor competitive–ness was due to some economic matters, such as poor infrastructure, burdensome business regulations by central and/or regional governments, and so forth. Consequently, risk perception concerning the industrial sector remained high and it limited access to working capital. As for high utilization industries, financing was needed to raise production capacity. In addition to risk perception issue, the dependency for financing were determined by the success of corporate restructuring and regulatory reform to improve the business climate. As long as these problems remain unsolved, extension of investment credit will remain limited.

Other fundamental problems faced by industrial sector include the steady inflow of imported goods. Cheap imports have met a good part of demand, as domestic producers failed to successfully respond to competition, especially as regards to increased efficiency in production. In addition, continuing sluggish world demand implies limited foreign demand for Indonesia's exports. Moreover, business were burdened by increasing production costs due to the higher administered prices for fuels (*BBM*), increases in electricity tariffs and high labor wages, all of which undermined the competitiveness of Indonesian products.

In such conditions, it is hardly surprising that the growth of manufacturing was subdued. In 2003, this sector only grew by 3.5%, far lower than average growth of more than 10.7% in the pre crisis period. Low growth characterized both the oil/gas sub-sector and the non-oil/gas sub-sector. As regards non-oil/gas, lower growths were



Source : State Electricity Corporation (PLN)

Chart 2.20
Electricity Sales

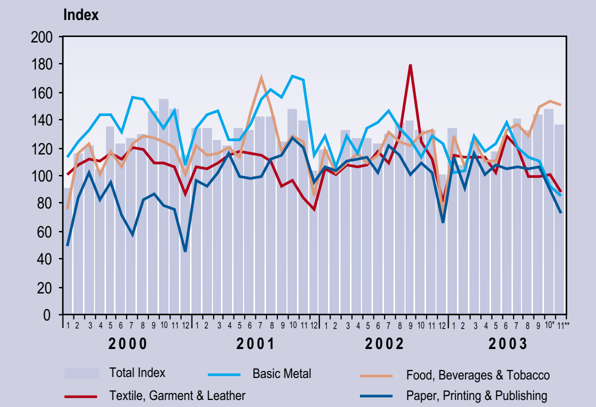
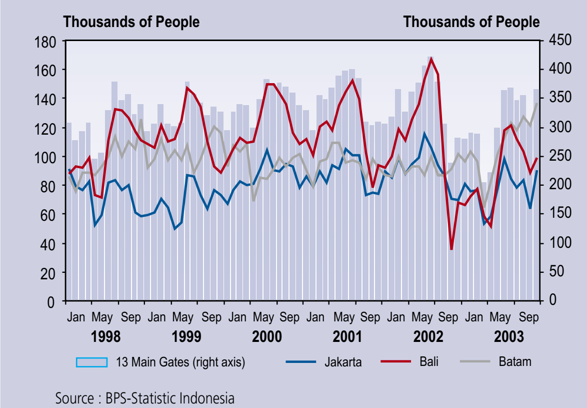


Chart 2.21
Production Index

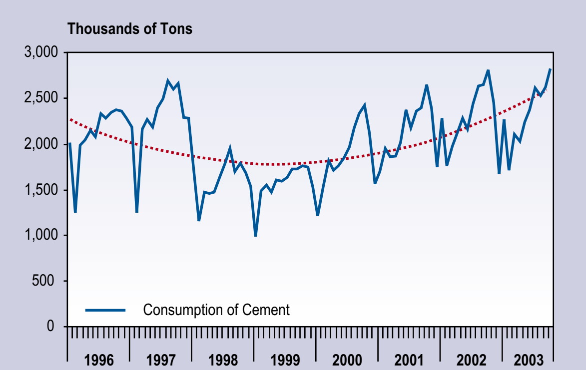


Source : BPS-Statistic Indonesia

Chart 2.23
Number of Foreign Visitors

recorded in the foodstuffs, beverages, and tobacco industries, all sums up to cover 50% of this sub-sector. This was reflected in sales of electric power to industry and the Production Index development, both of which changed slightly from 2002 (Chart 2.20 and 2.21).

Growth of the trade, hotel, and restaurant sector was stable at 3.7% in 2003. Activity in this sector was marked by the opening of new retailing outlets; strong growth in consumer credit; an upward trend in the Retail Sales Real Index; strong sales of motorcycles and cars; and rising cement consumption (Chart 2.4 and 2.22). Meanwhile, tourism has begun to recover with the main source coming from increased numbers of domestic tourists. The number of foreign tourists has not yet recovered following the Bali bombing (Chart 2.23).



Source : Ministry of Trade and Industry

Chart 2.22
Cement Consumption

Transportation and communications expanded strongly, at 10.7%. This was the only sector whose growth surpassed average growth of the pre-crisis period. In the transportation sub-sector, the main contributor of growth was air transportion due to deregulated air tariffs, which led to soaring demand for air services, met in part by expansion of airlines' fleets. Growth of land transportation, which accounts for more than 50.0% of total transportation, was relatively stable. Railway transportation continued its decline, which began in 2001. As regards the communications sub-sector, growth was supported by investments in telecommunications, especially for CDMA-based wireless networks, and by government plans to build additional fixed line networks.

One of the sectors enjoying higher incomes and economic growth was construction. This sector accelerated quite sharply from 4.9% in 2002 to 6.7% in 2003. Much of this high growth originated in regional infrastructure, such as airports, roads, irrigation, residential and commercial properties. As regards commercial property, rapid development took place in retail construction. Other indicators of high activity on the construction were cement consumption and extensions of housing credit (Chart 2.22).

The agricultural sector expanded by 2.5%, up from 2.0% in 2002. The main contributors to this growth were the staple crops (most notably paddy, corn, and tapioca products) and plantation sub-sectors. Notwithstanding a long draught, forecast of the Statistics of Indonesia indicated that paddy production in 2003 reached 51.9 million tons of dry hulled paddy, up 0.7% (or 0.4 million tons) over 2002 production. The increase was partly due to the program of Intensification Quality Improvement in the form of procurement of seed, fertilizer, and radiation, which increased productivity by 4,5 ton/ha. In addition, the accelerated planting period and use of compound fertilizer are estimated to have increased paddy production by 1.5 – 3 ton/ha. As regards the procurement of fertilizers, the government has issued regulations on the procurement and extension of subsidized fertilizers for agriculture, covering staple crops, cattle breeding, and people's plantations. On this basis, a paddy production target of 52 million ton could be achieved. The plantation sub-sector (which relies on oil palm, cacao, and rubber) will be assisted by the establishment of the International Rubber Consortium – IRCo Ltd. by Indonesia, Malaysia, and Thailand in Bali in October, 2003. This Consortium would stabilize rubber prices in the international market, thereby stimulating production, especially for exports. As a further boost to this sub-sector, the productivity of cacao farmers in North Sumatra rose from an average of 600–800 kg to 1,150–1,300 kg/ha/year due to improved the traditional pest control. However, the growth of this sub-sector could still be increased by as much as 80%, because the crop in Eastern Indonesia was not processed optimally due to a lack of infrastructure. As regards the fisheries sub-sector, the government has launched programs for the elimination of theft through reorganization of the fish catch licensing, improved ocean supervision and law enforcement, quick and just legal action, and improved quality of the fishing fleet.

The finance, rental and business services sector also expanded rapidly in 2003, by 6.3%, the highest since the crisis. The main contributor to this growth was the banking sub-sector, which increased its profits, despite limited expansion of credit. Meanwhile, the increased overall economic activity helped the rental building and business services sub-sectors.

By contrast with other sectors, the mining sector contracted, with the oil and gas sub-sector declining significantly for the third consecutive year. This was due in part to rehabilitation work on some oil wells. In 2003, oil production was recorded at 1.14 million barrel/day, down from 1.24 million barrels/day in 2002. The non-oil and gas mining sub-sector still grew, due to increased production of coal; other mining products (such as tin, lead, copper, nickel, and aluminum) declined.

Reflecting the general increase in economic activity, the electricity, gas, and clean water sector also recorded relatively high growth. With a capacity utilization rate of only 48%, the State Electricity Company (*PLN*) was able to easily step up its supply to meet the rising overall demand. Additional supply from private electricity was another source of growth in this sector.

Despite acceleration from 2002, the structure of economic growth in 2003 suggested that the current economic structure is inadequate to serve as a foundation for sustained growth. The failure of domestic goods production sector to meet rising consumption demand

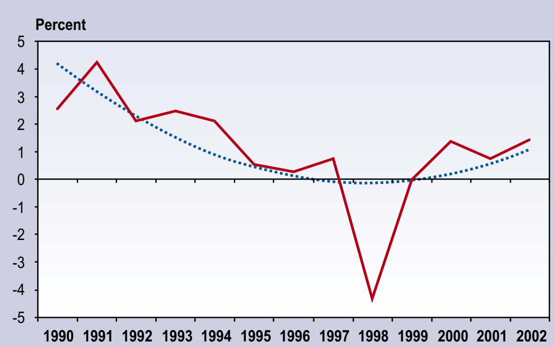


Chart 2.24
Total Factor Productivity

Table 2.4
Rank of Technology Utilization and Its Components

	Innovation	ICT*	Technology Transfer	Technology
China	70	62	47	65
Hong Kong	34	8	-	37
India	66	75	7	64
South Korea	7	11	-	6
Malaysia	41	32	1	20
Philippines	49	67	12	56
Singapore	15	6	-	12
Taiwan	2	7	-	3
Thailand	37	45	4	39
Vietnam	69	82	30	73
Indonesia	65	74	63	78

* Implementation of Information Technology and Communication
Source : World Economic Forum

has led to lower multiplier effects, which limited increases in incomes. As further evidence, there was a steadily tapering-off in the savings-to-GDP ratio, implying dissaving in the economy that could limit domestic investment (Chart 2.1).

From the side of technological progress, indicators improved, but total factor productivity [7] has yet to return to pre-crisis growth rate (Chart 2.24). The low rate of technological progress in post-1998 Indonesia was highlighted by the Indonesian Technology Index in the survey results of the *World Economic Forum* "Global Competitiveness Report 2003-2004" (Table 2.4).[8] Considering only aspect of technological application, Indonesia ranked dead last among comparator countries due to its low rate of technological absorption.[9] From the side of innovation, Indonesia ranked somewhat better than India, Vietnam, and China. Considering applications of information and communications, Indonesia was somewhat better than only India and Vietnam.

MANPOWER

Against the above background, overall economic growth has produced additional employment for approximately 1.1 million people. At the same time, the labor force expanded by 2.4 million people.[10] Consequently, overall growth did not produce enough new jobs to reduce the unemployment rate. Indeed, the number of unemployed is estimated to have reached 10.1 million people in 2003, the highest since the onset of the crisis in 1997 (Table 2.5).

Rising numbers of open unemployed were also related to the structure of economic growth by sector. The declining role of manufacturing —which has the largest backward-forward linkages— and the increased role of

7 The growth of Total Production Factor (…A/A) is calculated using "Solow residual" approach on the accounting equation of economic growth: …A/A = ….Y/Y – a…L/L – (1-a)…mK/mK.
8 Technology Index is one of the components forming Economic Growth Competitiveness Index, in addition to Macroeconomic Condition Index and Public Institution Index.
9 Taiwan, Singapore, South Korea and Hongkong do not have technology transfer value since they are considered core technology countries (close to technology frontier). In composite, countries considered as core technology countries gain high weight for innovation criteria.
10 Bappenas Projection figure

Table 2.5
Labor Force and Unemployment

(Millions of Person)

	1997	1998	1999	2000	2001	2002	2003*
Population	195.8	198.5	200.3	205.8	208.9	212.0	215.2
Economically Active Population	135.1	138.6	141.1	141.2	144.0	148.4	150.9
Labor Force	89.6	92.7	94.8	95.7	98.8	100.5	102.9
Labor Force Participation Rate (%)	66.3	66.9	67.2	67.8	68.6	67.9	68.2
Employed	85.4	87.7	88.8	89.8	90.8	91.6	92.8
Semi Unemployed	28.0	31.9	31.43	0.13	0.42	8.9	31.5
Open Unemployment	4.2	5.1	6.0	5.8	8.0	9.1	10.1
Open Unemployment Rate (%)	4.7	5.5	6.4	6.1	8.1	9.3	9.8
Open Unemployment & Semi Unemployed	32.2	37.0	37.4	35.9	38.4	38.0	41.6
Open Unemployment Rate & Semi Unemployed Rate (%)	36.0	39.9	39.4	37.5	38.9	41.0	40.4

Sources : - Ministry of Manpower
- National Planning Board Projection

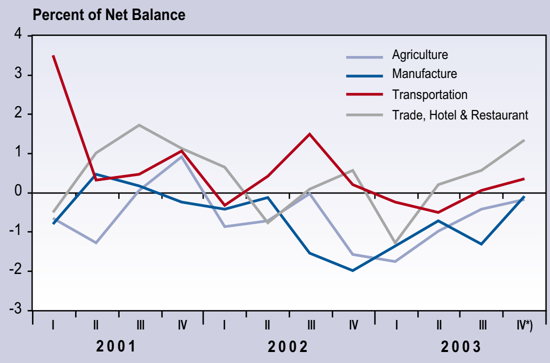


Chart 2.25
Employment by Sectors

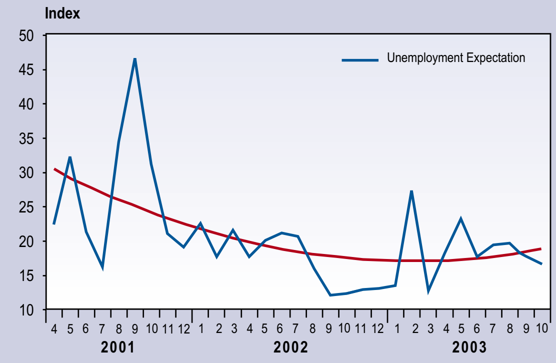
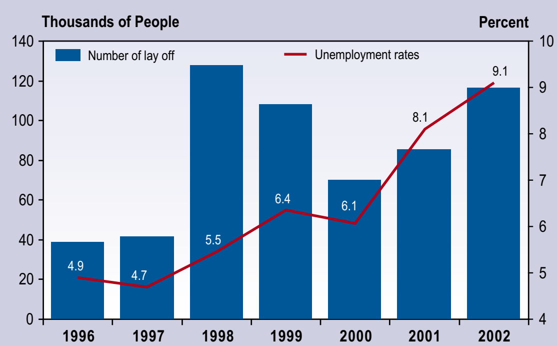


Chart 2.27
Unemployment Expectation

trade and transportation reduced overall capacity to absorb labor. In addition, opportunities to work abroad, which have often been an alternative outlet for Indonesian manpower, could not contribute significantly to improved labor conditions due to problems of low quality of labor and of working permits.

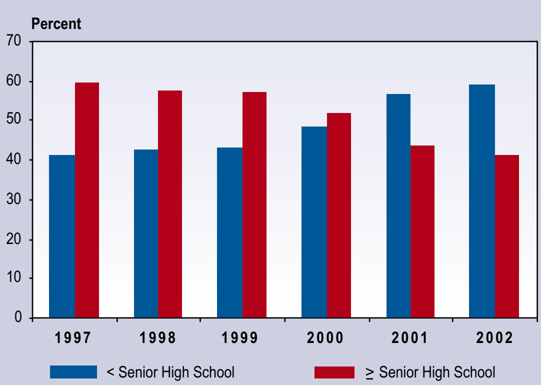
Problems faced by the manufacturing sector, as stated earlier, magnified problems of limited new employment. The trend of employment in various sectors, as indicated by the results of Business Survey, was a picture of scarce employment opportunities (Chart 2.25). Unfavorable business conditions even forced some large companies in areas like textiles, footwear, tourism and transportation, to downsize or to halt production. Consequently, layoffs in 2003 were still high (Chart 2.26). The high level of unemployment was also reflected in the Consumer Survey that indicated increasing public expectations of unemployment, indicative of continuing deep public pessimism about the economy's capacity to absorb the growing numbers of unemployed (Chart 2.27).

With low demand for labor and swelling supply, competition in the labor market is becoming intense. One indicator in this regard was unemployment by education level (Chart 2.28). The data up to 2002 showed a decline in unemployment among workers with educational background of senior high school or above. For lower levels of education, the number of unemployed increased. This suggests that individuals with higher education are taking on jobs normally held by persons with lower



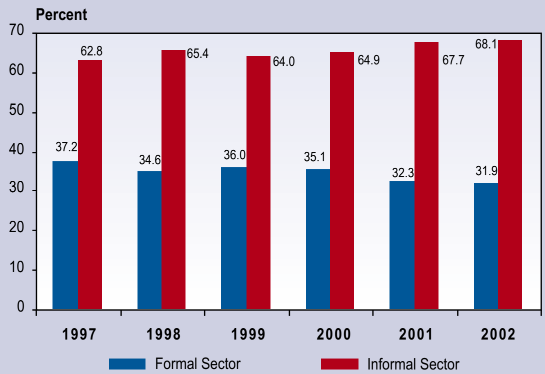
Sources : BPS-Statistic Indonesia and Ministry Manpower, Processed

Chart 2.26
Number of Laid-off Workers



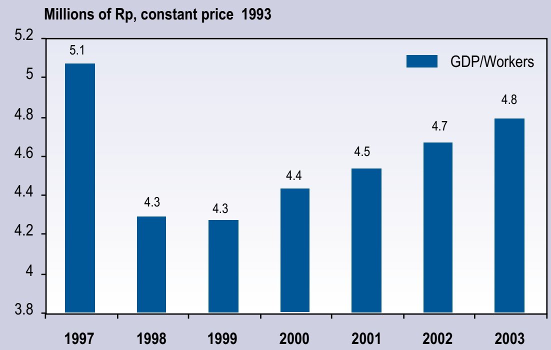
Source : BPS-Statistic Indonesia

Chart 2.28
Share of Unemployment by Education Level



Source : BPS-Statistic Indonesia

Chart 2.29
Workers Proportion in of Formal-Informal Sectors



Sources : BPS-Statistic Indonesia and Ministry of Manpower, processed

Chart 2.30
Manpower Productivity

education. Tough competition in the labor market was also reflected in developments concerning jobs by profession. Higher economic growth was unable to increase the number of people working in the formal sector. Indeed, the proportion of workers in the formal sector trended downwards from 37.2% in 1997 to 31.9% in 2002 (Chart 2.29). Conversely, the population working in the informal sector increased to 67.1% in 2002. The number of informal sector workers was high because many people lost their formal sector jobs and became self-employed or independent workers.

Another indication of the changing structure of employment was implied by growing selective demand for labor. When corporations downsized, less skilled workers appear to have been released. Consequently, labor productivity has increased, especially in the manufacturing and trade sectors.

Finally, total labor force in 2003 was around 102.9 million person, comprising 92.8 million persons with jobs and 10.1 million openly unemployed (that is, seeking employment). Compared with the previous year, the number of persons with jobs increased only by 1.2%, while unemployment grew by 11.3%. This imbalanced growth resulted in 9.8% of unemployment compare to 9.3% in the previous year. The rate of total unemployment (comprising open unemployment and under-unemployment) reached 40.4% of the total labor force. This is the highest level since the onset of the crisis in 1997.

Despite these conditions, productivity of the labor force (as measured by the output-to-total-labor force ratio) tended to improve (Chart 2.30).[11] In aggregate, production inputs originating from labor force were becoming more efficient in contributing to total production because economic growth exceeded labor force growth.

11 Total GDP amount is used as proxi for national output.

Box Economic Growth and Social Welfare [1]

ECONOMIC GROWTH AND GDP PER CAPITA

After experiencing a steep fall in 1998 (-13.1%), Indonesia's real GDP growth continued to rise, reaching 4.1% by 2003. This record is quite favorable considering that the level of real GDP has surpassed the pre-crisis level. Nevertheless, looking more closely, one would see that the real per capita GDP remains below its pre-crisis period. (Chart 1).

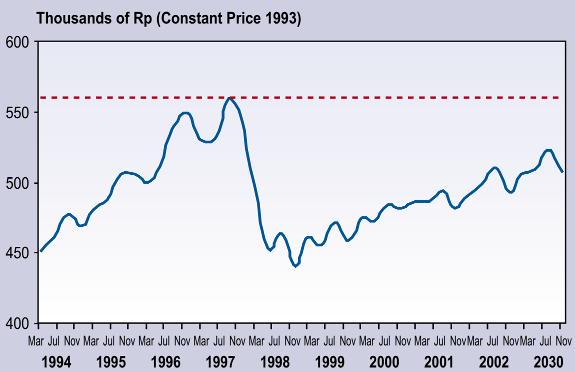


Chart 1
Indonesia Per Capita GDP

ECONOMIC GROWTH AND EQUALITY

The main objective of economic development is to provide people with a better standard of living. For its part, economic growth is essentially a necessary condition for achieving a higher level of social welfare. Yet, it could not guarantee that the fruits of higher economic growth are equally distributed among groups within the society. One of most common measures to address the issue of distribution is Gini coefficient that reflects the share of expenditure among different expenditure group.

Table 1
Expenditure Distribution and Gini Coefficient

Percent

Item	1996	1999	2003
Expenditure Distribution			
40% Low	20.3	21.7	20.6
40% Medium	35.1	37.8	37.1
20% High	44.7	40.6	42.3
Gini Coefficient	0.36	0.31	0.32

Source: BPS-Statistic Indonesia

During the early period of the crisis, the Gini coefficient improved from 0.36 to 0.31 (Table 1). However, the declining Gini coefficient does not necessarily mean that income gaps diluted during the crisis. At one side, with high inflation rate, consumption spending of the majority (mostly for basic needs) must increase as well. On the other side, , 20% of the highest spending group would tend to delay their spending, due to high interest rate offered by banks. By contrast, during the recovery the Gini coefficient did worse off. The deterioration in the Gini coefficient was driven by a rise in consumption spending by the 20% highest spending group, which would lower the consumption share of the other groups. In addition, the liberalization of imports including consumption goods, led to higher consumption spending by this group.

ECONOMIC GROWTH AND POVERTY

The high growth of the Indonesian economy in the last two decades has substantially reduced the

1 Summarized from Idris, Rendra Z., *Six Years of Economic Crisis: How Far Have We Come Back? A Research Note,* Directorate of Economic Research and Monetary Policy, Bank Indonesia, November 2003.
2 Using expenditure as the basis for comparison is not strictly appropriate due to differences in the marginal propensity to consume among different income groups. Nonetheless, this approach is often adopted due to the lack of reliable information on income.

population living in poverty. In 1981, 26.9% of Indonesians were living below the poverty line; in 2003, this proportion was down 17.4% (equivalent to 37.2 million people). Nonetheless, this number still reflects a relatively high incidence of poverty (Table 2).

High incidence of poverty is closely related to the availability of jobs. With relatively low economic growth, employment opportunities are limited, indeed, insufficient to absorb new entrants to the labor market. The scenario done by the National Development Planning Board (Bappenas) shows increasing open unemployment (Table 3).

Table 2
Number of Poor People

	Poor People (in million)	Percentage
1981	40.6	26.9
1984	35.0	21.6
1987	30.0	17.4
1990	27.2	15.1
1993	25.9	13.7
1996	34.5	17.7
1999	37.5	18.2
2000	38.7	19.1
2003	37.2	17.4

Source : BPS-Statistic Indonesia
Note : Since 1996 using 1998 standard adjusted with the current year consumption

Table 3
Employment Condition

	New Labor Force	Additional Job	Open Unemployment	
	(in million)	(in million)	(in million)	(percent)
1996	3.96	3.79	4.29	4.86
1999	2.11	1.14	6.03	6.36
2000	0.94	1.00	5.81	6.07
2001	3.16	0.97	8.00	8.10
2002	1.97	0.84	9.13	9.06
2003	2.10	1.10	10.13	9.85
2004	2.10	1.40	10.83	10.32
2005	2.10	1.75	11.19	10.45

Source : Bappenas
Notes : Up to 2002 using BPS-Statistic Indonesia Sakernas figure.
For 2001-2002 using adjusted open unemployment definition.
For 2003-2005 using projected Bappenas figure.

Chapter 3:
The Exchange Rate

Chapter 3: The Exchange Rate

The rupiah exchange rate managed to register some appreciation in 2003 within a generally stable framework. This development was the result of improved country risk assessment, increased supply of foreign exchange, attractive interest rate differentials and improved foreign exchange market sentiment. Also contributing to rupiah stability were consistant policies on macroeconomy and exchange rate stabilization coupled with strengthened monitoring and supervision on foreign exchange transactions. Despite some real appreciation of rupiah exchange rate, the currency was still considered to be undervalued, thereby providing support for export competitiveness.

The appreciation of rupiah with declining volatility which had occurred during 2002, continued in 2003. The currency appreciated by 6.3% against the US dollar (from Rp8,950 to Rp8,420 per dollar) during 2003, with the annual average registering a greater appreciation of 8.7% (from Rp9,318 to Rp8,572 per dollar). This performance made rupiah one of the best performing currencies in Asia-Pacific region during 2003. (Chart 3.1)

The relative stability of the rupiah exchange rate was reflected by its declining average daily volatility and its range of movement. Its volatility declined from 10.8% in 2001 to 6.1% in 2002, and 3.3% in 2003 (Chart 3.2). Its range of movement also steadily narrowed. During 2003, the rupiah traded against the US dollar in the range of Rp8,175 - Rp9,088 per dollar, as compared with Rp8,545 - Rp10,435 per dollar in 2002.

The appreciation trend and stable movement of the rupiah in 2003 was the result of improved country risk assessment, sufficient supply of foreign currency, attractive interest rate differential, and improved foreign exchange market sentiment.[1] A number of sovereign risk indicators exhibited improvements such as upgrading of the

1 See Chapter 1: Overview.

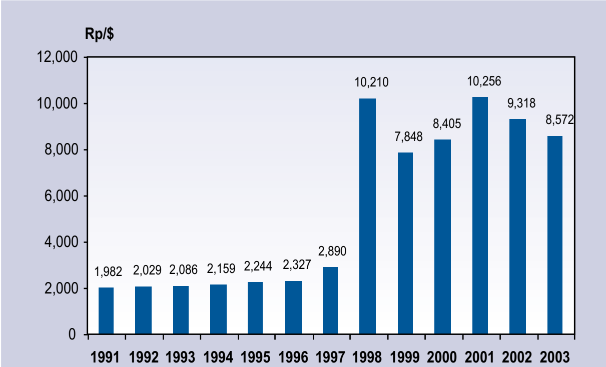


Chart 3.1
Daily Average Rupiah Exchange Rate

Chart 3.2
Volatility of the Rupiah Exchange Rate

Table 3.1
Dollar-Rupiah Spot Transactions of Domestic Bank and Offshore Parties

Thousands of $ Excl. Exchange Rate

Quarter/ Year	Total Domestic Bank			Total Foreign Bank			Average Exc. Rate Rp/$	Volume (S+D)
	Supply	Demand	S-D	Supply	Demand	S-D		
Quarter I 2003	3,140,812	2,667,507	473,305	2,917,318	2,561,776	355,542	8,902	5,808,319
Quarter II 2003	4,486,755	3,661,975	824,780	4,137,236	3,583,317	553,919	8,488	8,148,730
Quarter III 2003	3,881,872	3,500,456	381,416	3,601,548	3,328,516	273,032	8,431	7,382,328
Quarter IV 2003	2,235,773	2,148,385	87,388	2,030,570	2,055,352	(24,782)	8,474	4,384,158
2002 1)	6,232,930	6,004,227	228,703	5,519,381	5,722,867	(203,486)	9,318	12,237,157
2003	13,745,212	11,978,323	1,766,889	12,686,672	11,528,961	1,157,711	8,572	25,723,535
Monthly Average 2002 1)	779,075	750,502	28,573	689,881	715,332	(25,451)	9,318	1,529,577
Monthly Average 2003	1,145,434	998,194	147,241	1,057,223	960,747	96,476	8,572	2,143,628

1) New data available since May 2002
Note : Positive number implies net foreign exchange buying, negative number implies net foreign exchange selling
Source: PIPU-OLAP (transaction data), and Bloomberg (exchange rate data).

Indonesian debt rating, a fall in the swap premium rate, and the narrowed yield spread between Indonesia's Yankee Bond and the US Treasury Note. Sufficient supply of foreign currency in domestic market was indicated by surplus on the balance of payments (BOP), the rise in reserve assets, and the increased net inflows of foreign exchange from off-shore counter-parties to domestic bank in the spot market. The positive difference between foreign and domestic interest rate levels has been a major factor inducing significant capital inflows. Furthermore, the emergence of positive market sentiments has also been a factor bolstering the rupiah exhange rate.

The positive performance of rupiah exchange rate was also contributed by consistent macroeconomic policy and exchange rate stabilization policy. This resulted from the fiscal consolidation measures taken by the government aimed at attaining fiscal sustainability, combined with the implementation of monetary policy consistent with absorbing excess liquidity to hinder speculative flows.[2] In addition, Bank Indonesia has also pursued policies designed to maintain exchange rate stability such as the intensive monitoring of foreign exchange market transactions, moral suasion, sterilization/intervention into the exchange market, and improved regulation of the banks foreign exchange positions in order to curb speculative activities. The combination of the above policies was effective to mitigate exchange rate turbulence.

FOREIGN CURRENCY SUPPLY AND DEMAND

During 2003, foreign currency supply in the domestic market was sufficient. This was resulted mainly from significant capital inflows confirmed by BOP data and banks exchange rate transaction data. Furthermore, the implementation of Bank Indonesia's sterilization/ intervention policy has also contributed to the supply of foreign currencies in domestic market.

The balance of payments in 2003 recorded a surplus of $4.2 billion compared with $4.0 billion in 2002. As BOP recorded a surplus, the official reserve assets also rose from $32.0 billion in 2002 to $36.2 billion.[3] The rise in reserve assets has helped market confidence, as well as increased Bank Indonesia's capacity to maintain exchange rate stability.

Banks exchange rate transaction data also indicated quite signifcant capital inflows. Purchase of foreign currency made by the domestic banks from off-shore

2 See Chapter 5: Monetary and Chapter 7: Government Finance.

3 See Chapter 6: Balance of Payments.

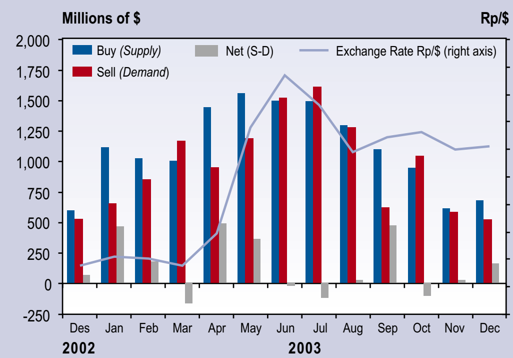


Chart 3.3
Dollar-Rupiah Spot Transactions : Domestic Bank v.s. Offshore Parties

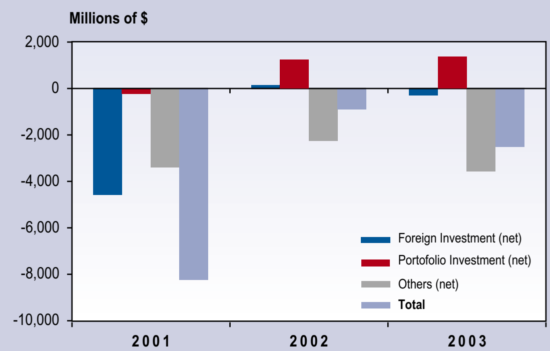


Chart 3.5
Private Capital Flows

counter parties (both bank and non-bank) in the s pot market reached $13.7 billion, while sales reached $12.0 billion (Table 3.1).[4] Domestic banks recorded net purchase of foreign currency in the amount of $1,766.9 million from off-shore parties, or a monthly average of $147.2 million. Most of the transactions with offshore counter-parties were made by foreign banks (Chart 3.3 and 3.4). This position was larger as compared with 2002, when monthly net purchases of foreign currencies from offshore counter parties amounted to only $28.6 million.

Nevertheless, the increased capital inflows needed to be monitored as most of them were characterized as short-term and in the form of portfolio investments. The possibilities of negative market sentiment presence, which may deteriorate market confidence at any time, could trigger reversal of capital (Chart 3.5). Such capital reversals often resulted in a contagion effect, inducing residents to convert rupiah funds into foreign currencies (run on reserves).

The increase in short-term investments was an indication that it was still of interest to foreign investors to invest in domestic financial market. This was supported by the high potential profits reflected in the difference of Indonesian nominal interest rate (non-risk adjusted) compared with other countries (Chart 3.6). Furthermore, the Indonesian swap rate was still higher compared with that of several other countries (Chart 3.7).

4 Particularly the dollar-rupiah spot transaction.

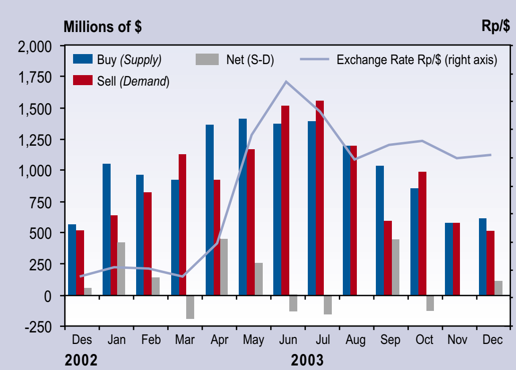


Chart 3.4
Dollar-Rupiah Spot Transactions : Foreign Bank v.s. Offshore Parties

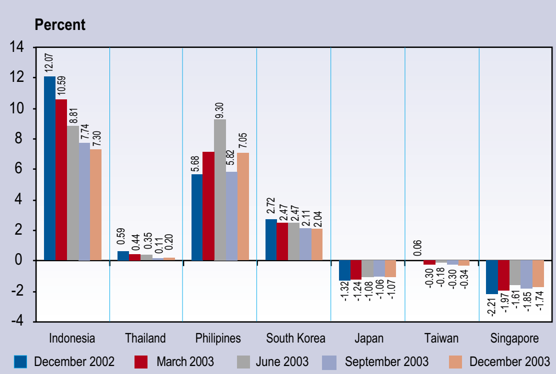


Chart 3.6
Nominal Interest Rate Differential in Several Countries

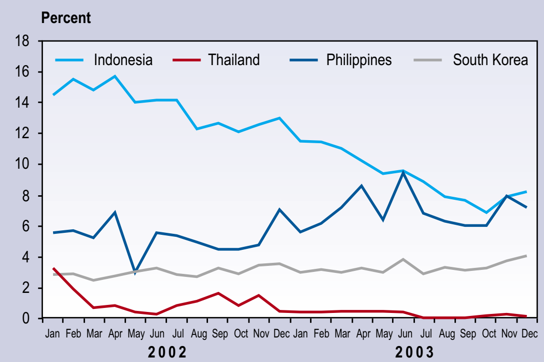


Chart 3.7
Swap Premium in Several Countries

Other factors that supported foreign capital inflows included improved economic fundamental, more varied rupiah investment outlet, and the emergence of positive market sentiments. Improved Indonesian economic fundamentals, as reflected *inter alia* by higher economic growth, a declining inflation rate, and a controlled budget deficit, has boosted market confidence. The range of rupiah investments, such as the recent issues of bonds, mutual funds, the implementation of bank's divestment program, and privatization of state-owned enterprises, has provided investors with a greater scope of options for the allocation of their rupiah portfolios. At the same time, positive market sentiment that helped boost the rupiah exchange rate during 2003 was also accompanied, among other things, by the downward trend of the US dollar and the government's commitment to fight against money laundering.

COUNTRY RISK

The appreciation of the rupiah within a framework of stability was sustained by the improvement in some of the key risk indicators. In general, the country risk assessment of Indonesia has improved, as reflected in the upgrading of Indonesia's sovereign debt rating. During the period under review, two international rating institutions—Standard & Poor's (S&P) and Moody's—twice upgraded Indonesia's debt rating twice up to B+ and B2, respectively (Table 3.2). Fitch IBCA also upgraded Indonesia to B+. These credit upgrades were not only based on a set of consistently implemented macroeconomic policies but were also due to increased optimism as to Indonesia's economic potential and prospects. S&P and Moody's also upgraded several domestic banks, including Bank Mandiri, Danamon, BNI and BRI, which also provided positive grounds during their efforts to raise equity capital.

The improvement of Indonesia's country risk rating was also reflected in the improvement of some other risk indicators. Short-term indicators such as the swap premium rate registered declines over all maturities (Chart 3.8): the 1-month swap premium rate declined from 13.01% at the end of 2002 to 8.27% at the end of 2003, while the 3-month swap rate premium declined from 12,74% to 7.60%. Over the same period as the 1-month SIBOR interest rate fell from 1.38% to 1.13%, the rate of the 1-month implied swap premium declined from 14.39% to 9.40%. However, the implied swap premium was still above the 1-month SBI interest rate, which had also declined to 8.31% by the end of 2003, thereby providing opportunities for arbitrage.

Table 3.2
Sovereign (Foreign Currency Long Term) Debt Ratings

Country	S&P		MOODY'S		FITCH IBCA	
	Rating	Effective	Rating	Effective	Rating	Effective
Malaysia	A-	8-Oct-02	Baa1	25-Sep-02	BBB+	7-Aug-02
	BBB+	20-Aug-02	Baa2 *+	24-Jun-02	BBB	7-Dec-99
	BBB	10-Nov-99	Baa2	17-Oct-00	BBB- *+	9-Sep-99
Thailand	BBB	8-Oct-03	Baa3	21-Jun-00	BBB	3-Sep-03
	BBB-	8-Jan-98	Ba1 *+	3-Apr-00	BBB-	24-Jun-99
	BBB	24-Oct-97	Ba1	21-Dec-97	BB+ *+	26-Apr-99
Philippines	BB	24-Apr-03	Ba1	18-May-97	BB	12-Jun-03
	BB+	21-Feb-97	Ba2 *+	23-Jan-97	BB+	15-Mar-01
	BB	30-May-95	Ba2	12-May-95	BB+ *-	17-Jan-01
Indonesia	B	8-Oct-03	B2	30-Sep-03	B+	20-Nov-03
	B-	12-May-03	B3 *+	26-Jun-03	B	1-Aug-02
	CCC+	5-Sep-02	B3	20-Mar-98	B-	16-Mar-98

Investment Grade   Non-investment/Speculative Grade

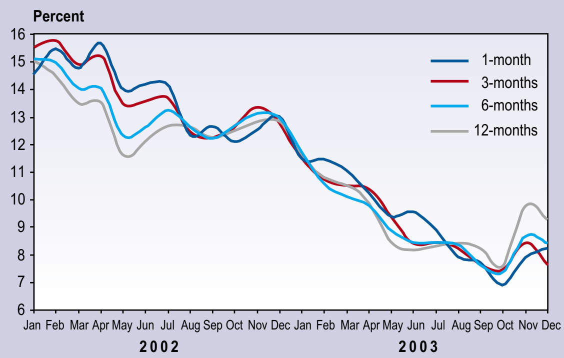


Chart 3.8
Swap Premium

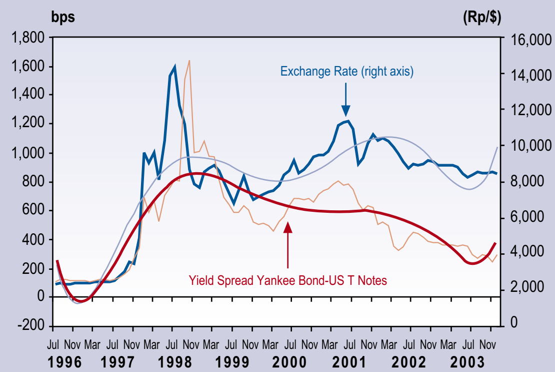


Chart 3.10
Exchange Rate and Swap Premium

Although the swap premium, as well as foreign and domestic interest rates declined, the covered interest rate parity (CIP) did not improve as it fell from –0.94% to –0.97% (Chart 3.9). Such a negative figure has in fact been a disincentive to investors holding rupiah denominated assets (nominal risk adjusted). This suggests that investment risk in Indonesia is still relatively high compared to some other competitor countries. This indicator also suggests that the scope for further domestic interest reductions has narrowed, thereby implying that the policy of further interest rate reductions has to be followed with prudence.

Over the longer-term, Indonesia's sovereign risk premium, as measured by the spread of the outstanding Yankee Bond over comparable US Treasuries, narrowed substantially, falling from 402 basis points to 287 basis points (Chart 3.10).[5] The narrowing spread was due to faster fall in the yield of the Indonesian Yankee Bond relative to that of the US Treasury Notes. This also corroborated the continued improvement in market expectations for the rupiah. In the long term, the movement of the exchange rate and of the risk premium appeared to be in the same direction and can be considered a valid long-term risk indicator.

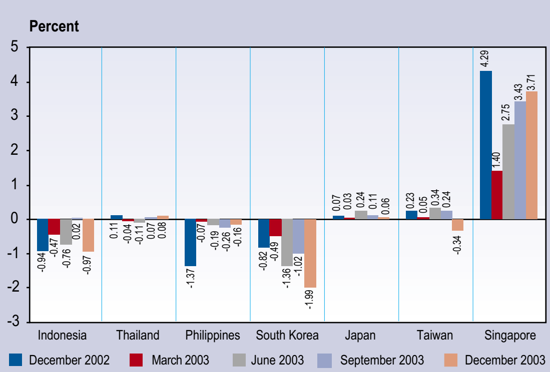


Chart 3.9
Covered Interest Rate Parity
in Several Countries

SENTIMENT FACTOR

The rupiah exchange rate movements were also inseparable from sentiment factors, both negative and positive. These sentiment factors had a significant short-term impact on exchange rate movements. Various events provoked positive sentiments on the exchange rate, such as the general downward trend of the US dollar, the enactment of anti-money laundering laws, the credit rating upgrade, the divestment of some banks, the privatization of state-owned enterprises, improved macroeconomic indicators (announcement effect), and IMF loan

5 Risk premium is calculated from the 10 year yield spread between 10 year Indonesian Yankee Bond and US Treasury Notes matured by 2006.

disbursements. All these helped boost market confidence in the rupiah

There were also moments when the stability of the rupiah was affected by the emergence of negative sentiments, such as the impact of electricity base rate tariff rises and fuel oil price rises, the US invasion to Iraq, SARS epidemic, political tension escalation during the run-up to the 2003 annual session of the People's Consultative Assembly, rumors that the rupiah exchange rate might be overvalued, security issues such as the various bombings, and embezzlement cases in a few state-owned banks.

Overall, positive market sentiment did uplift the rupiah exchange rate, although the rate of appreciation was on various occasions hindered by the emergence of various negative sentiment factors. However, other factors, such as decreased risk, adequate supply of foreign exchange in the market, higher returns on rupiah instruments, improved economic fundamentals as well as Bank Indonesia's commitment to maintaining exchange rate stability turned out to play a greater role in determining the development of the rupiah's exchange rate. In itself, this was evidence that Indonesia's economy was robust enough to withstand such non-economic shocks.

REAL EXCHANGE RATE

Along with the nominal appreciation of the rupiah during the reporting period, the currency's real exchange rate also strengthened as reflected by the Real Effective Exchange Rate (REER) index, which improved from 85.15 at the end of 2002 to 88.82 at the end of 2003 (Chart 3.11). However, the fact that the REER index remains below the key 100 level seems to indicate that the current rupiah exchange rate remains undervalued. Rupiah will be considered overvalued until the nominal value reach Rp7,479 per dollar.

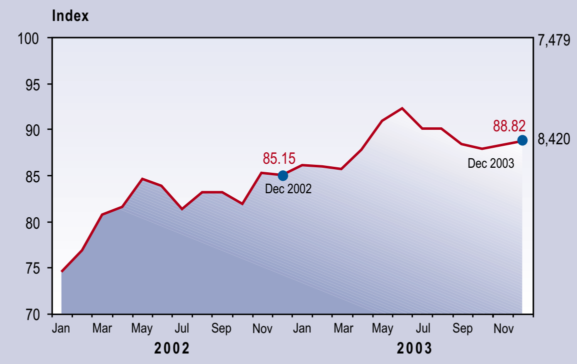


Chart 3.11
Real Effective Exchange Rate (REER)

The appreciation of the rupiah during the reporting period, however, did not negatively affect the country's export competitiveness. This may be discerned from the Rupiah's Bilateral Real Exchange Rate (BEER) index, which at the end of 2003 reached 68.31. Such level was relatively in line with the composite BRER index of the main competitor currencies, which reached 68.21.[6] (Charts 3.12 and 3.13). Nevertheless, export competitiveness is not only determined by the exchange rate but also by a number of other factors which include, among others, world demand, as well as efficiency and productivity in the export sector.

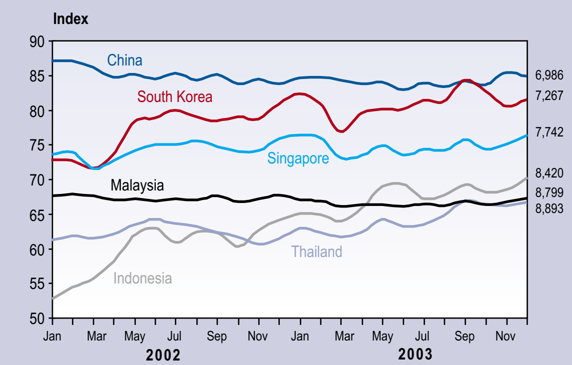


Chart 3.12
Bilateral Real Exchange Rate (BRER)

6 Major export competitor countries are the Philippines, Thailand, Malaysia and China whose currencies were also undervalued. The BEER composite index is obtained by weighting each country's export value to the US.

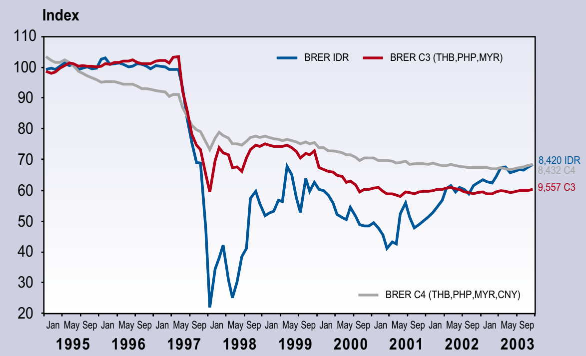


Chart 3.13
BRER Composite

Results of empirical studies show that although the rupiah exchange rate did had some effects on the performance of non-oil and gas exports, its contribution was relatively low (a 1% change in the level of the exchange rate only affected non-oil and gas export performance by 0.42%).[7] The impact of the rupiah's exchange rate movement on export performance turned out to be lower than that of demand changes among trading partners, especially the US and Singapore. As such, the rupiah's nominal exchange rate level of 8,420 against the US dollar at the end of 2003 is not believed to negatively affect competitiveness and is adequate for boosting Indonesian exports.

EXCHANGE RATE STABILIZATION POLICY

Foreign Currency Transaction Supervision and Moral Suasion

Bank Indonesia continuously monitored foreign currency transaction activities, either indirectly (off-site supervision) or directly (on-site supervision). Indirect supervision was conducted through the Dealing Room, analysis of interbank transaction data recorded with the Money Market Information Centre (PIPU), foreign exchange flows (LLD), as well as data provided by the banks' monthly reports to Bank Indonesia.

During the reporting period, Bank Indonesia conducted a number of on-site supervision visits among the main banks active in the market. Such visits were conducted ahead of the 2003 annual session of the People's Consultative Assembly 2003, when the political environment was marked by growing concerns, and while the foreign investors interest shifted from rupiah denominated bond investments (high yielding currency) to off-shore stock exchanges (high growth asset) on the back of efforts by a foreign financial institution to reduce their rupiah exposure. These supervisory measures, later combined with foreign currency intervention, proved sufficiently effective in subduing market pressures on the rupiah and led the currency to gradually stabilize near the Rp8,400 level against the US dollar.

The degree of bank compliance with the various foreign exchange regulations also contributed positively to the rupiah's stability during 2003. Speculative activities in the foreign exchange market decreased as reflected by the downward trend in the level of Banks' net open position (NOP), which continued to be well below the maximum level of 20% (Chart 3.14). The limited scope for speculation in the foreign currency market was achieved by tightness in Bank Indonesia's supervisory efforts in respect to the implementation of Bank Indonesia Regulation (PBI) No. 3/3/2001 limiting rupiah transactions

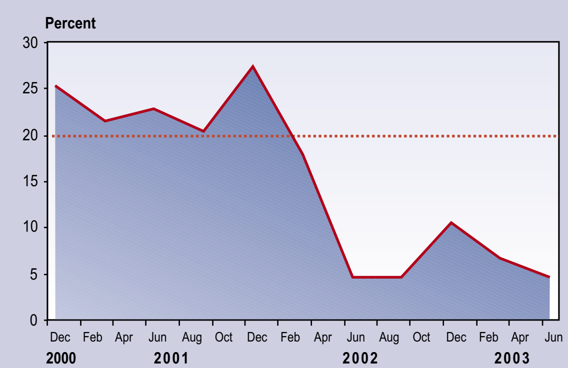


Chart 3.14
Banks' Net Open Position

7 Bank Indonesia, Directorate of Economic Research and Monetary Policy, *Responding to the Rupiah Appreciatio,* June 2003.

and the provision of foreign exchange credit by banks. The regulation has contributed to the rupiah's stability and to the decline in the currency's volatility level since 2001.

In addition to supervising foreign currency transactions, Bank Indonesia, on various occasions, reiterated its commitment to maintain exchange rate stability. Such moral suasion was undertaken to nurture market confidence by sending a message to market participants not to react excessively to negative factors unsubstantiated by fundamental conditions. Verbal intervention was expected to help minimize exchange fluctuations, especially when the rupiah came under downward pressure. Such measures did in fact helped maintain exchange rate stability, particularly in the first four months of the reporting period, despite negative pressure against the rupiah brought by mass demonstration against the elimination of price controls and the American military invasion to Iraq, as well as negative repercussions of the SARS epidemic.

Foreign Currency Intervention Implementation

Foreign currency intervention policy was intended, ultimately, to maintain rupiah exchange rate stability, especially at times when negative factors weighted on the rupiah. However, foreign exchange intervention was undertaken only when moral suasion was deemed to be ineffective in calming market participants and curbing excessive exchange rate movements. In addition, the sale of US dollars in the foreign exchange market was executed to provide a resistance level for the currency and prevent penetration by market participants. Nevertheless, policy implementation was always undertaken with due consideration of supply-demand conditions in the foreign currency market.

Foreign exchange intervention always adhered to internal Bank Indonesia guidelines and regulations, which emphasize efficient implementation taking into account market liquidity conditions, transaction turnover, and market psychology. In addition, before resorting to intervention operations, the source of price pressures on the rupiah were always taken into consideration, whether they originated at home or abroad. Execution of foreign currency intervention policy was undertaken at random intervals, both in regards to timing and size, in order to avoid predictability. Consequently, intervention operations were conducted on a measurable and careful manner, keeping in mind the importance of foreign exchange reserve adequacy.

Foreign exchange intervention operations carried out during 2003 proved effective in minimizing excessive exchange rate volatility. This was observable from the rupiah's performance during the year, which was far more stable than in previous years.

Improvement of Regulations

To further support the supervision of foreign exchange transactions, Bank Indonesia issued a number of regulations during the year i.e., Bank Indonesia Regulation (PBI) No. 5/24/PBI/2003, dated October 31, 2003, in reference to Money Market Information Centers, and Circular Letter No. 3/34/DPD, dated December 24, 2003, on procedures for the submission of data in reference to foreign exchange transaction through PIPU. These new regulations are expected to enhance the accuracy of foreign exchange transaction reporting by banks. These regulations deal with reporting procedures, including timing, and impose sanctions should the reports provided by the banks not adhere to the regulations. In addition, PBI No. 3/3/2001, dated January 12, 2001, on the limitation of rupiah transaction and the provision of foreign currency credit by banks, were streamlined. However, in general, current regulations are deemed adequate to limit speculative activities in the foreign exchange markets.

Chapter 4:
Inflation

Chapter 4: Inflation

Consumer Price Index (CPI) inflation in 2003 declined as the exchange rate strengthened and public expectations on inflation improved. The sharp decline in the CPI measure of inflation helped by an increase in foodstuff supply and the abatement in the inflationary impact of government policy on administered prices.

The rate of inflation during 2003 trended downward. The CPI measure of inflation was recorded at 5.06% in 2003, a sharp decline compared to that in 2002 (10.03%). This decline reflected decreased prices in the foodstuff category and smaller price increases in all other categories of goods. Various other inflationary indicators also showed a downward trend, though not as sharp as that of CPI inflation. Fundamentally, the causes of the decline in inflationary pressure were the strengthened rupiah exchange rate and the lessening of inflationary expectations. The interaction of aggregate demand and supply showed moderate development and did not exert significant upward price pressures. Meanwhile, non-fundamental factors that contributed to the decline of inflation were foodstuff category favorable supply shocks[1] and weakening inflationary pressures originated from government price policy.

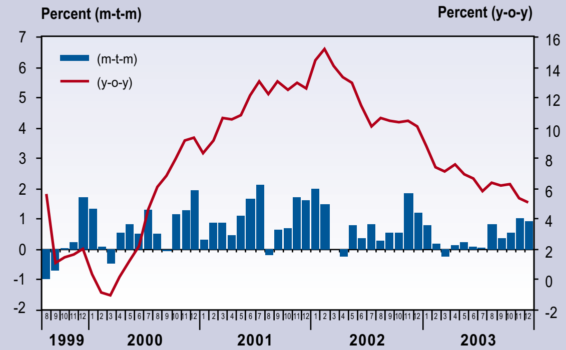
The various factors pushing down the inflation rate eventually led to the 2003 CPI inflation rate being well under Bank Indonesia initial target (9% ±1%). This was caused by the realization of various variables, both those belonging to fundamental and non-fundamental factors, being lower than was assumed in the beginning of the year. Out of the two factors, the non fundamental factors contributed more to the decline of CPI inflation. This confirmed that inflation structure in Indonesia was affected more by supply side and as such was very susceptible to supply shock.

INFLATION DEVELOPMENT

In line with the development of CPI inflation, various other indicators of inflation in 2003 also showed downward trends. This was seen in the development of some inflation indicators such as core inflation, the Wholesale Price Index (WPI) rate of inflation, and the GDP deflator rate of inflation.

CPI Inflation

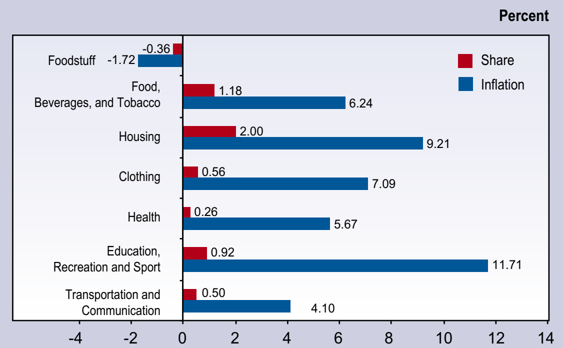
The prices of goods and services during 2003 were under less pressure to increase than in 2002. This condition was reflected in the CPI inflation rate falling to 5.06%, compared with 10.03% in 2002. On a monthly basis during 2003, inflation occurred in all months except March during



Source: BPS-Statistics Indonesia

Chart 4.1.
Monthly and Yearly CPI Inflation

1 Abundant foodstuff supply would reduce prices.



Source: BPS-Statistics Indonesia

Chart 4.2
Contribution of CPI Inflation by Category in 2003

which there was a deflation of 0.23%. The highest monthly inflation of 1.01% occurred in November, in line with the normal seasonal pattern in the face of the Eid'l Fitr Holiday (Chart 4.1).

The main contributors to inflation in 2003 in declining order were, the housing category, the processed food category, and the educational, recreational and sport category. Unlike other categories, the foodstuff category in 2003 recorded a deflation (Chart 4.2). All goods categories recorded lower inflation than in the previous year, excluding the textile category, the health category, and the education, recreation, and sport category (Table 4.1).

Table 4.1
CPI Inflation by Category

(Percent)

Category	2000	2001	2002	2003
Foodstuff	4.00	12.03	9.13	-1.72
Prepared Food, Beverage, and Cigarettes	11.08	14.48	9.18	6.24
Housing	10.10	13.59	12.71	9.21
Clothing	10.19	8.14	2.69	7.09
Health	9.57	8.92	5.63	5.67
Education, Recreation, dan Sport	17.51	11.90	10.85	11.71
Transportation and Communication	12.66	14.16	15.52	4.10
CPI	**9.35**	**12.55**	**10.03**	**5.06**

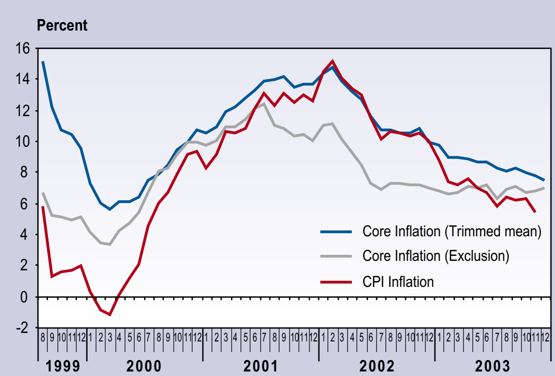
Source : BPS-Statistics Indonesia (processed)

By sub-categories of goods and related components, the main contributor to inflation in the housing category was the residential costs sub-category reflecting higher housing rentals and increased wages of low-skilled labor and household maids. The other main contributing sub-category was fuel, lightning, and water due to the increased electricity tariff. In the processed food category, the main contributor to inflation was the increase in the prices of refined sugar, rice, and noodles. The significant increase in the costs of all levels of education, from kindergarten to university led to the education sub-category having the highest inflation compared to that of other sub-categories. The deflation in foodstuff category was contributed to mainly by decreases in the prices of the food spices sub-category and the meat and related products sub-category.

Other Inflation Indicators

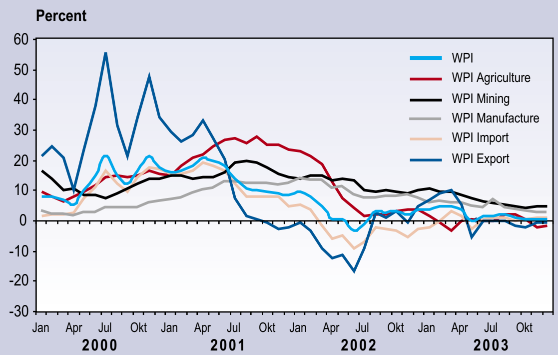
Core inflation which reflects the fundamental development of prices, showed a downward trend. Core inflation by *trimmed mean*[2] in 2003 fall to 7.40% from 9.90% in the previous year. Meanwhile, core inflation by *exclusion*[3] showed relatively stable development with a

2 Excluding the extreme price changes every month from the CPI component.
3 Excluding permanently various number of goods which price formation mechanism are distorted, such as administered price and volatile food price.



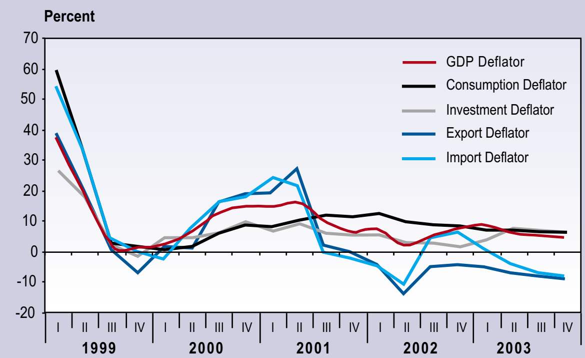
Source: BPS-Statistics Indonesia (processed)

Chart 4.3
CPI and Core Inflation



Source: BPS-Statistics Indonesia (processed)

Chart 4.4
WPI Inflation



Source: BPS-Statistics Indonesia (processed)

Chart 4.5
GDP Deflator Inflation

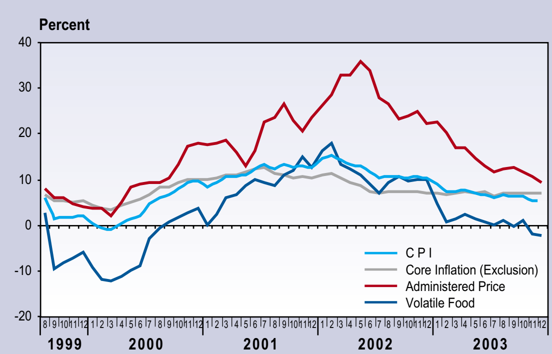
slight decrease to 6.93% from 6.96% in 2002 (Chart 4.3). Based upon the calculation method of core inflation that exclude *shock* factors from the CPI inflation component, declining core inflation implies lower pressure on inflation stemming from various fundamental factors.

The **WPI inflation** in 2003 significantly decreased from 3.92% in 2002 to 0.71% (Chart 4.4). Again, the main cause of the low WPI inflation originated in the decrease in the prices of foodstuff of which the change in the WPI of agricultural products decreased from 3.63% to –1.75%. Further, the decrease in WPI inflation was driven by lower rate of change in all WPI components, except that of import WPI which slightly increased (Chart 4.4).

The development of **GDP deflator inflation** was in line with the other inflation indicators, falling to 5.13% from 7.97% in the previous year (Chart 4.5). By component of GDP spending, excluding the investment deflator, all deflators of GDP spending components showed lower inflation than in 2002. The strengthening of the rupiah exchange rate in 2003 reduced the rate of change of both the export and import deflators to 8.57% and 7.99% respectively. From the production side of sectoral GDP components, comprising nine sectors, the GDP deflators inflation decrease originated in the decrease in the rate of change of the deflator for agriculture, mining, manufacturing, electricity, trade, transportation, and banking which underwent significant declines compared to the previous year.

FACTORS AFFECTING INFLATION

The decreased inflation in 2003 was due to both fundamental and non-fundamental factors. Improved fundamental factors covering lower inflationary expectations, the relatively balanced interaction of aggregate supply and demand, and the strengthened rupiah exchange rate were reflected in the decline of core inflation. The development of non-fundamental factors comprised the transmission of the government



Source: BPS-Statistics Indonesia (processed)

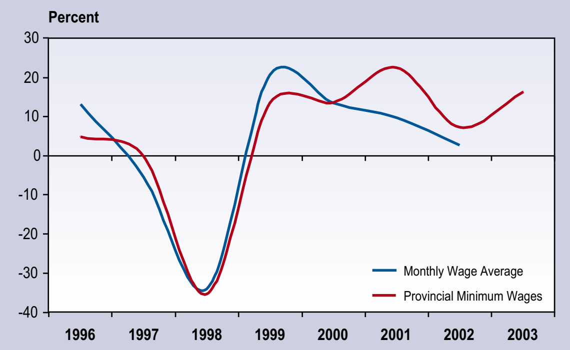
Chart 4.6
Core and Non-Core Inflation

administered prices policy and the existence of favorable supply shocks upon foodstuffs that led to declining food prices. This development was seen in the development of non-core inflation comprising administered prices and volatile food prices that sharply declined. The development of all these factors led to significantly decreased CPI inflation during the year 2003 (Chart 4.6).

Fundamental Factors

Interactions between Aggregate Demand and Supply

The balanced interaction of aggregate supply and demand in 2003 indicated a slight rise in aggregate demand. Despite rising aggregate demand, as shown by higher economic growth during 2003, the change was offset by adequate aggregate supply; thanks to the support of imported goods. This condition was in line with the development of other real sector indicators such as increased real wages, increased retail sales index, increased production index, and increased export volume which showed that in general interaction between aggregate demand and aggregate supply [4] did not add any significant inflationary pressures.



Source: BPS-Statistics Indonesia (processed)

Chart 4.8
Wages and Provincial Minimum Wages Real

Increasing demand was seen in increasing GDP growth, retail sales volume, and real wage growth. The retail sales index at the end of 2003 rose significantly to 156.6 as against 127.8 in the previous year (Chart 4.7). In addition increased demand stemming from increased buying power was reflected in increased real wage growth in 2003. This was seen in the increase of real wage growth[5] by 16.3%, well above the increase of 7.3% in the previous year (Chart 4.8).

On the supply side, the increased demand was responded to, in addition to domestic products, by an increased supply of imported goods. Notwithstanding the improved development, the growth of production in the

4 See subchapter aggregate demand and aggregate supply in Chapter 2.

5 Real regional minimum wage with CPI as deflator

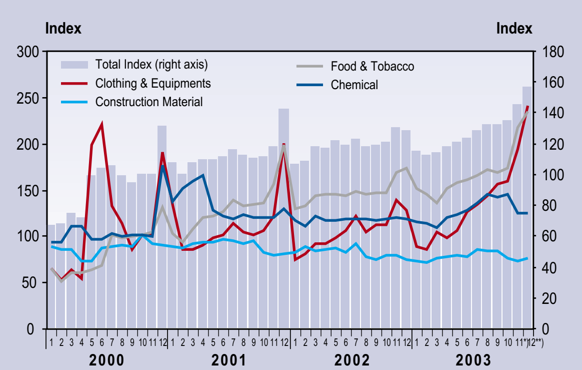
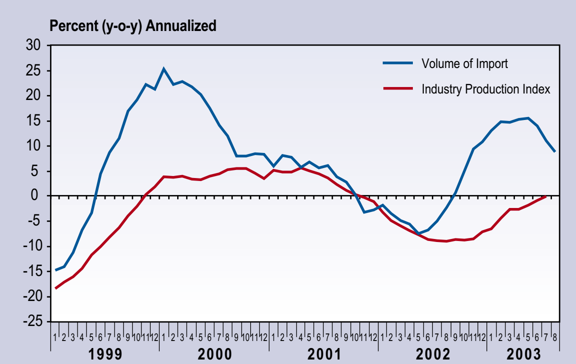


Chart 4.7
Retail Sales Index



Source: BPS-Statistics Indonesia (processed)

Chart 4.9
Volume Import Growth and Production Index

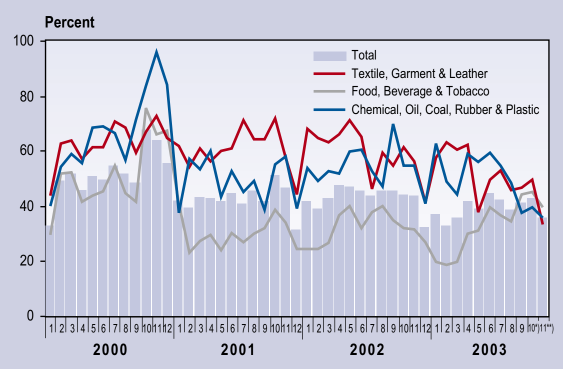
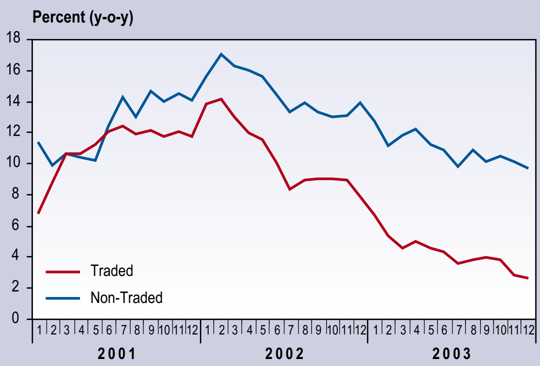


Chart 4.10
Capacity Utilization



Source: BPS-Statistics Indonesia (processed)

Chart 4.11
Inflation Traded and Non-traded

industry sector in 2003 was still relatively limited indicated by the growth of Industrial Production Index (annual growth up to July) of 0.05%. This relatively limited production growth was also reflected on the rate of production capacity utilization which remained relatively unchanged compared to that of the previous year (Chart 4.10). However, this limited domestic production was appreciably aided by increased imports so that goods supplied were relatively able to match demand. Increased import activity, triggered among others by the strengthened exchange rate, was seen in the increased annualized imports volume growth through August 2003 of 8.8% (Chart 4.9).

External Factor

The development of external factors exerted reduced inflationary pressure in relation to the strengthened rupiah exchange rate and the declining rate of inflation in major trade partner countries in 2003 compared with 2002 (Chart 4.11). Aside from the direct impact of the appreciation of the rupiah (direct pass through) which reduced the price of imported goods, the strengthening of the exchange rate also had an indirect impact (indirect pass through) on the increase of import volume in 2003. The relative increase in the supply of *traded goods* (internationally tradable goods) had a favorable effect on price in the domestic market. The impact of external factor, was seen in the reduction in inflation in the traded goods category compared to that of the non-traded goods category (Chart 4.12).

In addition, the strengthened exchange rate accompanied by decreased volatility gave larger impact to non-core inflation rather than to the core one. This was reflected in decreased inflation of the traded goods category, which was mainly comprised of foodstuff commodities.[6] Meanwhile, the decreased inflation in some of Indonesia's main trade partner countries also contributed to the decrease of external inflationary pressure. The composite inflation of the trade partner countries decreased from 1.3% in 2002 to 1.2% in 2003.

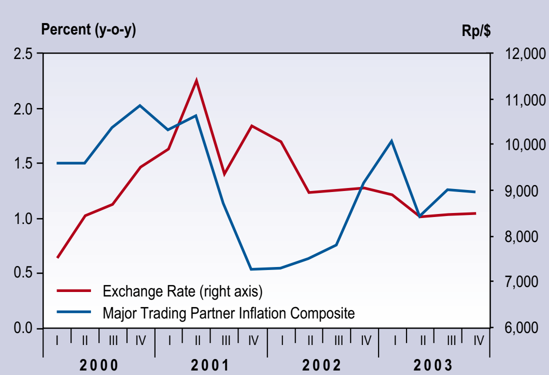


Chart 4.12
Rupiah Exchange Rate and Major Trading Partner

6 The weight of foodstuff within the food category is 28%

Inflationary Expectations

Inflationary expectation development in 2003 improved as is indicated by lessening inflationary expectations. This was seen in the tapering off of the index of expectations, both of consumers and traders.[7] These lessened inflation expectations were triggered, among others, by the impact of the government administered price policy, the rupiah exchange rate, and the decreased rate of inflation in the previous period.

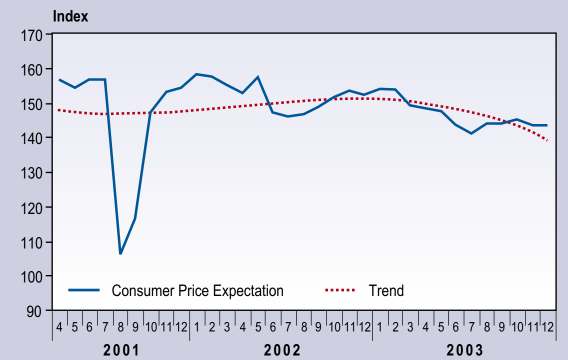


Chart 4.13
Consumer Expectation on Inflation

Non-fundamental Factor

In 2003, non-fundamental factor defined in this case as shock factors provoking short-term inflation turbulence, induced quite significant (non-core) inflation decline.

Government Policy on Administered Prices

The realization of government policy on price in 2003 was far lower than in previous years. This was mainly due to: (i) the modified pricing formula of fuel oil, (ii) the cancellation of the 2003-4th quarter electricity base rate increases, and (iii) the absence of a cigarette excise tax increase for 2003. The impact of this development was seen in the significantly reduced administered prices inflation of 9.1% in 2003 compared with 22.1% in the previous year.

In the beginning of 2003 the government revised the fuel price formula in a cabinet session on January 20, 2003 and basically, ruled that there would be no fuel oil price increase as long as world oil price had remained not too far from the 2003 State Budget assumptions. These policies led to minimal increases in fuel oil prices in 2003, far lower than in the previous year. The second factor was the lower hike of the electricity base rate compared to the previous year. At first the electricity basic rate increase was planned to be executed every three months (Presidential Decree No. 89 of 2002). In practice, the electricity base rate increase was applied only up to the third quarter of 2003, while the increase for the 4th quarter of 2003 was cancelled by Presidential Decree No. 76 of 2003 dated October 1, 2003. Consequently, the increase in the electricity base rate was lower compared with that of 2002. Lastly, there was no cigarette excise tax increase undertaken in 2003. This was due to the expected achievement of target 2003 excise revenue without any increase.

Despite the reduced impact of government policies on prices and incomes on inflation in 2003 compared with the previous year, administered prices nonetheless made a significant contribution to inflation during the year.

Supply Shock

Food commodities are quite susceptible to supply shocks from either production or distribution sides. This susceptibility led to high fluctuations of foodstuff prices compared to prices of other commodity categories. In 2003, a favorable supply shock originating in abundant domestic output and imports led to a general decline in the price of foodstuffs. This development was observable in the sharp fall in the volatile food category index with deflation of 2.4%. In the previous year this commodity category recorded 9.7% inflation.

7 Lower expectation index was attributable to a less number of respondents expecting higher prices.

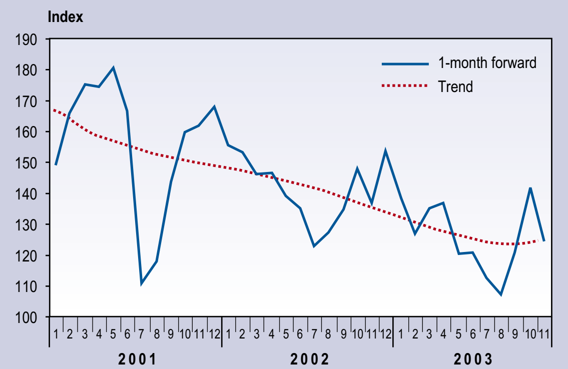


Chart 4.14.
Traders' Expectation on Inflation

Foodstuff commodities that experienced deflation and have significant weight in the CPI basket were, among others, rice, beef, red chilis, red onions, and vegetable tomatoes. Commodities such as rice underwent price declines due to rising production and imports. Other commodities such as red chilis, red onions, and tomatoes underwent price declines due to increased local production. The price decline of beef and chicken were due to increased production as well as increased imports as they become cheaper due to the exchange rate appreciation.

INFLATION STRUCTURE

The development of CPI inflation in 2003 indicates that the structure of Indonesia's inflation might be characterized by a supply-side dominated price formation mechanism that is susceptible to supply shocks. The structure of inflation also indicates some rigidity in the process of price formation at the level of producers so that it takes quite a long time for monetary policy to affect prices.

The predominant role of the supply side is mainly caused by relatively high direct (input) cost effect on the price formation mechanism at all levels of the supply and distribution channel.[8] This condition led to instability in price level towards the changes in direct cost resulting from supply side disturbances (e.g. food supply disturbance and administered prices changes). The impact of this factor to the CPI inflation is significant since it shares about 40% on CPI basket.

8 Bank Indonesia Survey, under the research on Dynamic Price Formation and Wages

Table 4.2
Estimate and Realized Inflation in 2003

(Percent)

Disaggregation Inflation	Inflation 2003		
	Initial Estimate	Realization	Deviation
Core Inflation	8	6.93	1.07
Administered Inflation	16.7	9.08	7.59
Volatile Food Inflation	5.3	-2.36	7.69
CPI Inflation	**9**	**5.03**	**3.97**

The price formation process, particularly at the levels of producers and wholesalers is staggered so that in the short term there is some rigidity in the price change process.[8] This results in a "lag effect" of monetary policy on the inflation rate, as a change in monetary policy is not rapidly responded to by a price change. This lag effect to real sector was prolonged due to some adjustment needed in financial sector.

EVALUATION OF CPI INFLATION TARGET ACHIEVEMENT

In the beginning of 2003 Bank Indonesia set a CPI inflation target of 9% with a deviation rate of ±1.00%. The target figure was set on the basis of a forecast of fundamental and non-fundamental factors based on information then available.

The realization of fundamental and non-fundamental factors turned out to be lower in exerting inflationary pressure compared with initial estimates, so that CPI inflation fell below the target. The development of non-fundamental factors such as the implementation of government policy on prices and favorable shocks to food supply exerted lower inflationary pressures than expected were the main causes of inflation deviation from the target. This development was seen in non-core inflation comprised of administered prices inflation and volatile food prices inflation both of which were lower than the initial estimates. Meanwhile, the development of fundamental factors also resulted in slightly lower inflationary pressures than was estimated and was also responsible for the low realized CPI inflation (Table 4.2).

Based on inflation structure and its transmission mechanism, lower inflationary pressure in 2003 was the result of monetary policy conducted in the previous year. The fact that the development of inflation in 2003 was lower than targeted has significantly contributed to the lowering of inflationary expectations. Under this condition, achievement of the medium-term inflation target of 6% in year 2006, is likely to be achieved by exercising monetary policy concurrently inducing positive signal for the real sector recovery.

Assumptions and Realization of Fundamental Factors

Actual values of fundamental variables that affected inflation in 2003, such as aggregate demand and supply interaction, the exchange rate and inflationary expectations were lower compared to relevant estimates in the beginning of the year and thereby exerted less inflationary pressure than expected. The impact of this was lower realization of core inflation at 6.93%, than the initial estimate of 8%.

At the beginning of the year Bank Indonesia predicted that there would be inflationary pressures arising from the predicted values of fundamental factors during 2003. The estimated core inflation in 2003 (8,00%) was higher compared to previous year (6.96%). The fundamental inflationary pressure was predicted to come from: (i) the likelihood of excess demand in 2003, in particular, resulting from slow investment over the last few years that constrained domestic supply growth, (ii) the occurrence of rupiah stability at Rp9,000 per US dollar and relatively stable inflation in some of trade partner countries of around 0.96%. These assumptions about the exchange rate and the condition in trade partner countries had a slight inflationary impact on the estimated 2003 inflation because the position of rupiah at the end of year 2002 (December) was Rp8,940 per US dollar and inflation rate of trade partner countries in the previous year was lower (0.90%), (iii)inflationary expectations were estimated to decline slightly in line with the stability of the exchange rate and the reduction of the estimate of the impact of government policy on administered prices.

However, in the course of the year 2003 macroeconomic conditions were better than predicted. Increase on demand was met by both domestic products and imports, the rupiah exchange rate strengthened at Rp8,572 per US dollar compared with the initial estimate, and inflationary expectations were lower than expected, in line with the strengthening of rupiah and the lower realization of the implementation of government policy on administered prices. This development led to declining core inflation to 6.93%, lower than to the initial estimate of 8% in the beginning of the year.

Assumptions and Realization of Non-fundamental Factors

As described above, non-fundamental factors were defined as disturbances (shocks) that could lead to inflation turbulence in the short term. The variables grouped as non-fundamental factors were, among others, government policy on administered prices and the development of foodstuff supply. In accordance with its highly volatile characteristics, realization of these non-fundamental factors significantly diverged from initial estimates so that the realization of development of administered inflation and volatile food inflation were much lower than initial estimates in the beginning of the year. This divergence constituted the main reason why the CPI measure of inflation was below the Bank Indonesia inflation target.

In the beginning of the year Bank Indonesia estimated that pressures from the administered prices would be significant. The expected pressures originated from high estimates of the government plan to increase electricity base rate (TDL), the fuel oil price, the telephone tariffs, and the toll rate. Furthermore, Bank Indonesia also estimated that there would be an increase in the cigarette retail price (HJE) based on the rise in the excise revenue target of the 2003 State Budget by 23%, amidst the estimated low sales of cigarettes. Against this background, the contribution of the hikes on CPI inflation was estimated to reach around 3%, which was equivalent to 16,7% increase in administered prices.

Over the course of the years, the government suspended and limited the rise of some of the administered prices, especially as regards the fuel oil, the telephone tariffs, and the electricity base rate in efforts to dampen social unrest in the face of 2004 general election. The suspension of the administered price hikes was supported by the capability of 2003 State Budget to cover the increased subsidy expenditures, which stemmed from windfall profits resulting from an increase in the world oil price and the decrease in debt interest payment as SBI rates decreased. In addition, the achievement of targeted excise revenue was supported by increased cigarette sales and this induced the government not to raise the cigarette excise rate (HJE). These developments caused the impact of the implementation of administered prices on CPI inflation to reach only around 0.90%. Administered prices rose by 9.10%, far lower than the initial estimate

.Bank Indonesia also estimated that there would be an excess demand of foodstuff supply, in line with estimated lower growth in the agricultural sector (around 1.4%). Against this background, inflation in volatile food was estimated to rise by 5.3%. However, in the agricultural sector growth turned out to be higher than the initial estimate (around 2.5%) and as such domestic foodstuff supply was quite abundant. In addition, food imports, especially rice, underwent an increase so that rice supply was more than adequate to meet the demand. The abundant supply conditions and the pass through effect of rupiah appreciation for imported foodstuff eventually led to a significant decline of volatile food prices in 2003 by 2.4%.

Chapter 5:
Monetary Developments

Chapter 5: Monetary Developments

Monetary conditions during 2003 continued to improve and were consistent with efforts to achieve the targeted inflation rate. These conditions were reflected in firmed control in base money, strengthened exchange rate, and lower interest rates.

Monetary policy stance in 2003 was geared towards achieving the inflation target for the year. To that end, the monetary policy objective was to control growth in base money in line with real economy needs. This was done by focusing on controlling banking sector excess liquidity, while at the same time cautiously keeping open the possibility of lowering interest rates so as to maintain the economic recovery momentum.

This policy stance contributed to relatively slow base money growth during 2003 and was in herent with the falling inflation and appreciating exchange rate. In addition, improving socio-political and security conditions has fostered the formation of positive public expectations about inflation and this helped prevent excessive demand for banknotes.

Stable growth in money supply and improved expectations about lower inflation provided room for Bank Indonesia to signal a further interest rate decline. The lowering of interest rates during 2003 was conducted taking into consideration the development of real interest rates and the international and domestic interest rate differential. Reduction in monetary instrument interest rates were followed by faster declines in bank deposit interest rates. Meanwhile, bank credit interest rates also declined, albeit at a slower pace than deposit interest rates.

The slower decline in bank credit interest rates indicate that the monetary policy transmission through the interest rate channel was not yet optimal. although improved compared with 2002. At the same time, monetary policy transmission through other channels did run more smoothly. The decreased bank interest rate had fostered some changes in public asset portfolio from bank assets to non-bank assets. This encouraged stronger performance in the stock market, bonds, mutual funds *(reksadana)*, and the property sector.

EVALUATION OF MONETARY POLICY IN 2003

Evaluation of Base Money Achievement

Under the base money targeting framework, in the beginning of the year Bank Indonesia set a base money growth target around an average of 13% for 2003. The target was based on an assessment of economic growth prospects estimated in the range of 3.5%-4% and exchange rate estimated to keep strengthening in the range of Rp8,800-Rp9,200 per dollar, and in line with inflation target of 9% with a deviation of ±1%.

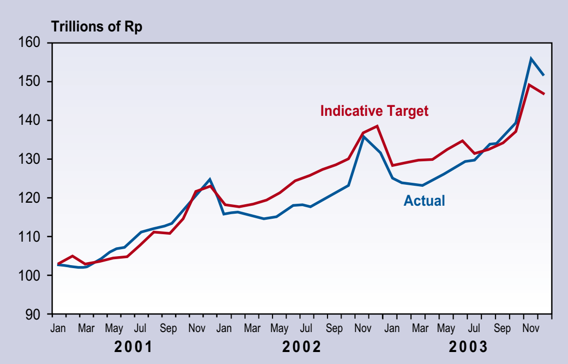


Chart 5.1
Indicative Target and Base Money Actuals

In the period of January-July 2003 (Chart 5.1) the amount of base money remained below its indicative target. This was inherent with reduced currency demand by the public and lower banking liquidity in response to lower inflation and strengthened exchange rate. In view of the improved macroeconomic conditions, i.e. economic growth estimated at 4%, exchange rate at around Rp8,536 per dollar, and inflation rate at around 6%, it was decided in the beginning of August, 2003 to adjust base money target to an average of 12%.

During the period of August through mid December of 2003 the base money tended to increase above the adjusted target. This tendency was due more to the shifting of the seasonal demand for currency and realized inflation in the period, which was higher than initially assumed. Overall, the expansion of base money was under control, as averaging 10.3%, well below the fixed target.

Evaluation of Open Market Operation (OMO) Strategy

The implementation of OMO during 2003 was intended to the control the excess growth in liquidity in the banking sector. The expansion mainly originated in the government's expanded account with Bank Indonesia (especially related to government bond transaction) and OMO interest payments. The effort to absorb excess liquidity was materialized through two main instruments: SBI auction and FASBI, as reflected in the position of both instruments, which grew by Rp23.2 trillion (Table 5.1).

Efforts to control excess liquidity, especially in the frame of limiting the potential use of excess liquidity for foreign currency speculation, was bolstered by optimizing available regulations such as Net Open Position (NOP).[1] Overall, banking NOP was held under the maximum level of 20%. In addition, Bank Indonesia exerted moral suasion on the banking sector and relevant government agencies to help reduce banks' excess liquidity by increasing bank credit. Meanwhile, foreign exchange sterilization was used more for reducing rupiah exchange rate volatility, especially during turbulent periods.

Table 5.1.
Open Market Operation and Its Components

(Trillions of Rp)

2003	Changes		
	SBI[1)]	FASBI	OMO (SBI+FASBI)
Quarter I	-41,869	27,300	-14,569
Quarter II	-3,975	-10,779	-14,754
Quarter III	-9,736	-1,928	-11,664
Quarter IV	26,209	-8,460	17,749
Total	**-29,371**	**6,133**	**-23,238**

Notes : 1) including SWBI of Rp1,6 trillions at the and 2003 sebesar
(-) contraction / (+) expansion

In general, the adoption of OMO strategy had been able to maintain the development of base money in accordance with the target and absorb banks' excess liquidity as reflected in lower inflation and stable rupiah exchange rate. However, the maintenance of stable monetary conditions had raised Bank Indonesia costs of the OMO.

During 2003, the SBI auction target was generally set to the same amount as matured SBIs. Such a policy at the time when banking liquidity was abundant and investment prospects still not fully recovered, both in regard to type and risk (including credit expansion) æmade SBI an attractive portfolio investment for banks. It was this condition that resulted in bids continuously above the SBI target announcement throughout the year. Additionally, there was an indication that bidders were making bids in an amount exceeding the fund at hand (gapping) in order to win in the auction. The gapping phenomena indicated strong expectations of interest rate decreases among the bidders.

The signaling of auction target announcement one day prior to auction time by Bank Indonesia has so far

1 Difference between foreign exchange assets and liabilities both in on-and off-balance sheet.

been optimally read by the market. This was reflected among others from the relatively aligned trends of indicative target volume and SBI bidding volume. This condition at least suggested that the market understood the quantity signal, although in the reporting year Bank Indonesia was more explicit in signaling indicative interest rate than the previous year. Conversely, the auction target volume was also taken by Bank Indonesia as a strong reference in selecting winners in the OMO. In line with efforts to lower interest rates, Bank Indonesia more frequently tended to accept a smaller number of bids than the number of bids lodged.

To support the lowering of the SBI interest rate (box: *Chronology of SBI and FASBI Interest Rates Decline in 2003)*, the FASBI interest rate had been lowered 11 times in 2003. By the end of 2003 the FASBI interest rate had declined 413 bps, to 8.0%. (Chart 5.2). Additionally, a year after FASBI was instituted with dual windows and dual rates,[2] in 2003 FASBI of 2- to 7-day tenor was removed; making the O/N tenor as the sole placement option.

The efforts to absorb excess liquidity were also materialized through foreign exchange sterilization policy, though the amount was quite insignificant. This was related to Bank Indonesia's policy preference on smoothing out the rupiah exchange rate fluctuations through accumulation of exchange reserve.

The exchange reserve accumulation policy plays a great role in maintaining confidence in rupiah; hence preventing banks utilizing their excess liquidity for speculative purposes. Furthermore, the exchange reserve accumulation was strongly needed in anticipation of mounting official foreign debt repayments in 2004.

2 The dual window in the morning and afternoon session; and dual FASBI rates, i.e., the afternoon rate is half of the morning rate instituted per 18 September 2002 was aimed at preventing Bank Indonesia from offering higher discount rate for the remaining money market liquidity in the afternoon session and at encouraging banks to improve their liquidity management.

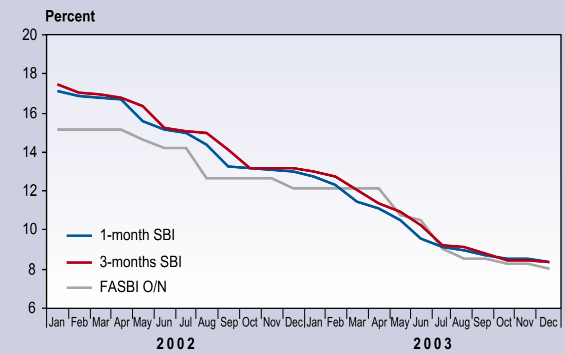


Chart 5.2
Interest Rate on Monetary Instruments

DEVELOPMENT OF CURRENCY IN CIRCULATION

Development of Base Money

Average annual growth of base money during 2003 was slightly increased during 2003 by 10.3% against the previous year of 9.2% (Chart 5.4). In December 2003, the outstanding base money was recorded at Rp166.5 trillion or higher by Rp28.2 trillion compared to the same period in 2002 (Rp138.3 trillion). **By component**, the increase in the base money originated from rising currency demand of Rp14.3 trillion and the banks' positive current account with Bank Indonesia of Rp14.0 trillion (Table 5.2). The increase in currency largely occurred in the 4th quarter of 2003 was closely associated with the rapid increase in transactions during long festivities of Idul Fitri, Christmas,

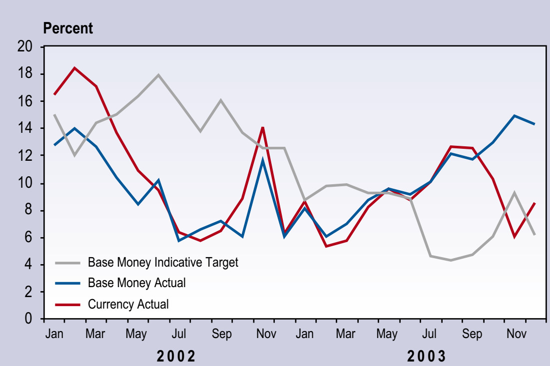


Chart 5.3.
Currency and Base Money Annual Growth
(Indicative Target and Actual)

Table 5.2.
Base Money

(Trillions of Rp)

	2001 December	2002 December	2003 March	2003 June	2003 September	2003 December	Annual Changes
Base Money	**127.8**	**138.3**	**125.2**	**132.4**	**136.5**	**166.5**	**28.2**
Bank notes and coins outside	91.3	98.4	87.4	92.2	96.5	112.7	14.3
- public	76.3	80.7	72.3	77.1	81.7	95.5	14.8
- bank	14.9	17.7	15.0	15.1	14.9	17.3	-0.5
Banks demand deposits at Bank Indonesia	34.8	38.2	35.9	38.4	38.2	52.2	14.0
Private sector demand deposits	1.7	1.6	1.9	1.8	1.7	1.5	-0.1
Net International Reserve (NIR) ($=Rp7000)	**128.1**	**151.8**	**158.8**	**165.3**	**165.4**	**169.4**	**17.6**
Net Domestic Assets (NDA)	**-0.3**	**-13.6**	**-33.6**	**-32.9**	**-28.9**	**-2.9**	**10.7**
1. Net claims on central goverment	160.8	168.5	171.7	187.6	180.9	174.2	5.7
2. Liquidity support	37.1	36.6	35.8	36.2	36.1	35.9	-0.7
3. Liquidity credit	15.1	14.4	14.3	14.2	13.9	13.7	-0.7
4. Other claims	1.9	2.4	2.5	2.6	2.8	2.5	0.2
5. Money market operation	-102.6	-113.3	-127.9	-142.6	-154.3	-136.5	-23.2
6. Net other items (NOI)	-112.4	-122.2	-130.1	-130.9	-108.3	-92.8	29.4

and New Year. Meanwhile, the rise in banks' positive current account with Bank Indonesia originated from the increase in the reserves requirement in line with higher banks mobilized deposits.

Despite continued increase in currency demand, its growth rate was relatively slow. Average growth of currency in 2003 was recorded at 8.8%, lower than that in the previous year of 11.1% (Chart 5.5).

The declining inflation rate below its initial target and the appreciating rupiah exchange rate led to lower growth in cash needed by the public. Also, based on survey results, the fast development of non-cash payment instruments in the form of debit cards and automatic teller machine (ATM) cards led to declining demand for cash by households for their daily transactions.[3] A similar survey also indicated the decreased need for banknotes for precautionary reasons in line with improved socio-political and security developments.

By factors affecting base money, the government rupiah account expansion and OMO costs remain the dominant sources of base money expansion. Net expansion of the rupiah government current account with Bank Indonesia in 2003 was recorded at Rp39.5 trillion. Government expenditures having an expansive impact mainly originated from government spending on salaries, General Allocation Fund (DAU), Profit Sharing Fund (DBH), coupon payment on government bonds, and project payments. Up to the end of 2003, government salaries

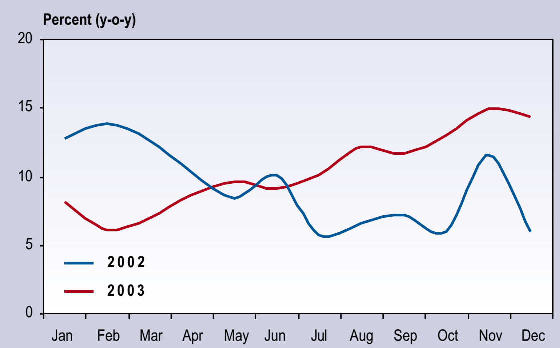


Chart 5.4.
Base Money Test Date Annual Growth

3 Survey of currency demand by households (Bank Indonesia 2003) indicates increased number of households are utilizing recent technology i.e., in the form of debit cards and ATM cards as payment instrument in their monthly routine transactions.

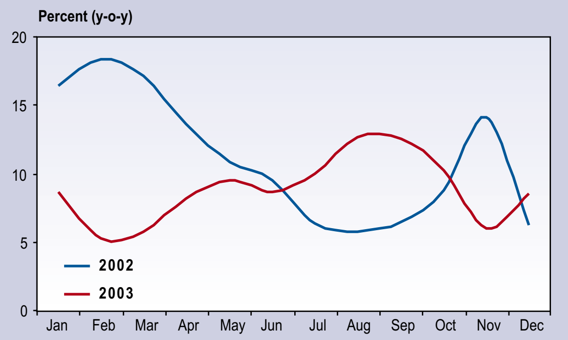


Chart 5.5.
Currency Annual Growth

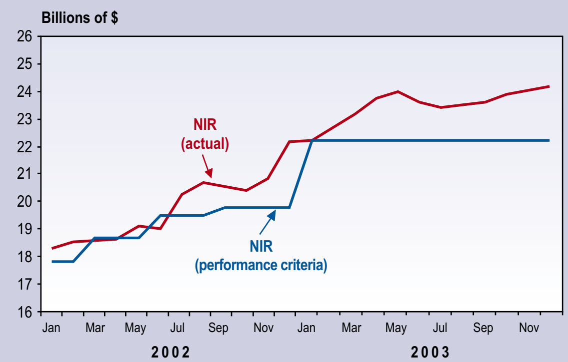


Chart 5.7.
Net Foreign Assets

and DAU were recorded at Rp125.0 trillion while DBH Rp21.6 trillion. Meanwhile, payments for bond coupon and project were recorded Rp45.6 trillion and Rp24.2 trillion, respectively. On the other side, government revenues having contractive impact mainly originated from increased tax collection, IBRA, and dividend revenues, respectively recorded Rp146.1 trillion, Rp21.9 trillion, and Rp9.2 trillion. Net expansion of the government rupiah account with Bank Indonesia occurring during 2003 has taken into account the contractive impact of the issuance of the State Bond (SUN) amounting to Rp11.5 trillion in 2003.

OMO activities during 2003 overall contracted base money by Rp23.2 trillion. The contractive impact originated from SBI was Rp29.4 trillion. Conversely, FASBI exerted an expansive impact of Rp6.1 trillion (Table 5.2). Rising expectations of interest rate decreases led banks to move their funds from very short term FASBI to longer term SBI.

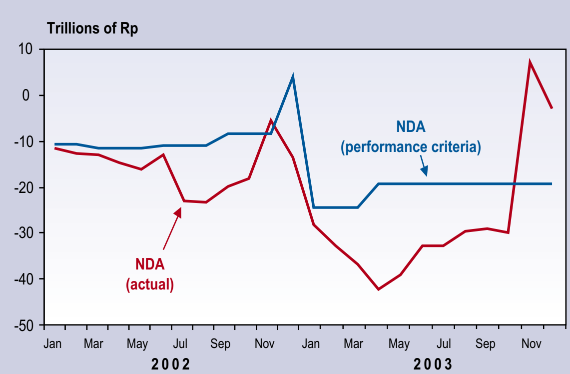


Chart 5.6.
Net Domestic Assets

The net domestic assets (NDA) in general was still below the target, except at the end of 2003 (Chart 5.6). By components, the increase in NDA mainly stemmed from the expansion in net other items (NOI) of Rp29.4 trillion. The NOI expansion was related to the settlement agreement on Bank Indonesia Liquidity Support (BLBI) between Bank Indonesia and the government (Box: *Resolution of the BLBI Issue By the Government and Bank Indonesia).*

The position of net international reserve (NIR) during 2003 remained above the minimum performance criteria with positive outlook (Chart 5.7). At the end of December the outstanding NIR reached $24.2 billion or $2.0 billion above the performance criteria. Increased NIR was due mainly to oil and gas revenue ($5.5 billion) and withdrawal of government foreign debt ($1.1 billion) which overall was bigger than debt service payment ($4.8 billion).

Development of M1 and M2

During 2003 the position of currency in circulation, both narrow money (M1) and broad (M2), kept increasing. Growth in M1 continued to increase while M2 was slowing. Growth rates of M1 and M2 in 2003 were 12.4% and

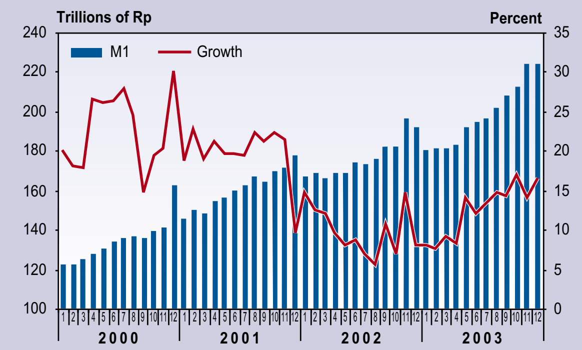


Chart 5.8.
Development in Nominal M1

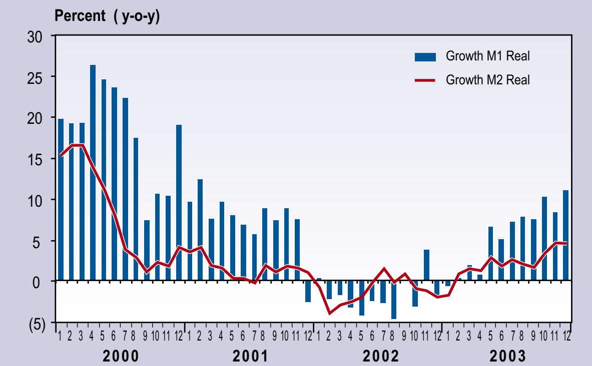


Chart 5.10.
Growth of Real M1 and M2

7.7% respectively, compared to 9.9% and 10.1%, respectively in 2002 (Chart 5.8 and 5.9). The higher growth rate in M1 was in line with an improved economic growth rate. Slow growth of M2 originated from several factors, among others: (1) slow creation of money due to banking intermediation function having not yet recovered; (2) the development of other alternative fund instruments, such as mutual funds (*reksadana*). Mutual funds posted better profit returns, which helped shift public assets from banks to non-banks, and declined interest earning in line with the declining interest rate.

Meanwhile, low inflation rate and increased economic growth implied an expanding real growth in M1 and M2. Real M1 grew on average 5% in 2003 as compared to minus 1.9% in 2002. Similarly, real rupiah M2 grew on average by 2.1% compared with minus 1.2% in the previous year (Chart 5.10).

During 2003, the money multipliers (mm) tended to decline (Chart 5.11). One of the causes was the relatively high demand for currency by the public at large, as reflected in the rising currency to deposit (C/D) ratio. Another factor causing the reduced money multiplier was the prolonged sluggish recovery in bank intermediation, which inhibited the banking sector money creation process.

At the end of the year, M1 was recorded at Rp223.8 trillion or an increase of Rp31.9 trillion as against Rp191.9 trillion at the end 2002. By component, the rise in M1 originated from expansion of Rp13.8 trillion in currency and Rp18.0 trillion in demand deposits (Table 5.3 and Chart 5.12). During the same period M2 increased by Rp71.8

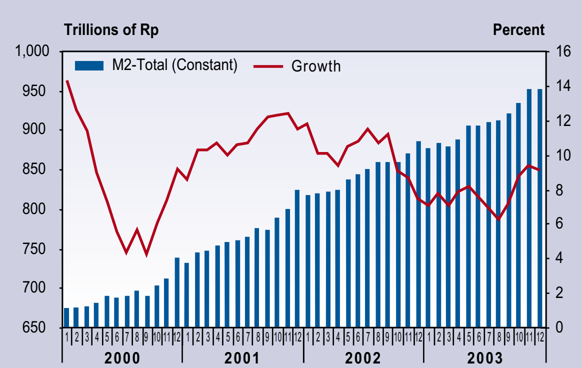


Chart 5.9.
Development in Nominal M2

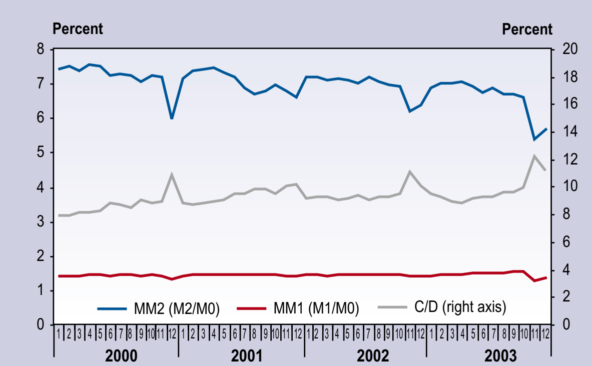


Chart 5.11.
mm1, mm2, and Currency Deposit Ratio

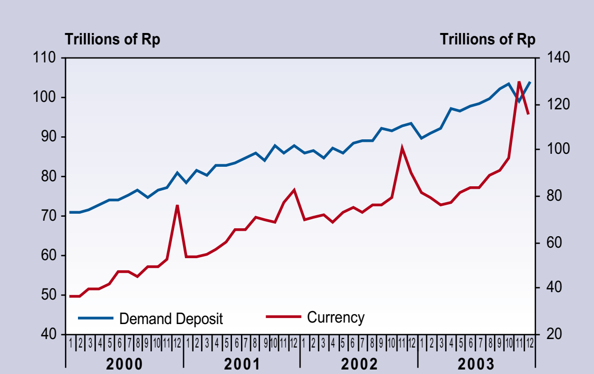


Chart 5.12.
Currency and Demand Deposits

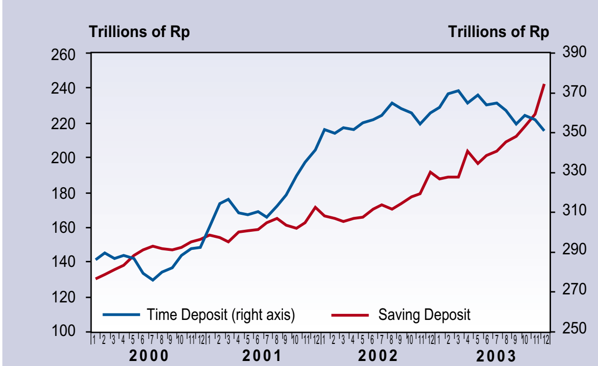


Chart 5.13.
Rupiah Saving and Time Deposits

trillion, reaching Rp955.7 trillion. The increase in M2, in addition to being attributable to larger M1, was also contributable to Rp39.9 trillion rise in quasi money.

By component, this rise in quasi-money largely occurred in rupiah saving deposits, while the rupiah time deposits and foreign currency saving deposits rendered negative contribution (Chart 5.13). Rupiah saving deposits during 2003 increased by Rp50.1 trillion, reaching

Table 5.3.
Money in Circulation

(Trillions of Rp)

Item	2000	2001	2002	2003	Changes 2003-2002
M1	**162.2**	**177.7**	**191.9**	**223.8**	**31.9**
Currency	72.4	76.3	80.7	94.5	13.8
Demand Deposits	89.8	101.4	111.3	129.3	18.0
M2	**747.0**	**844.1**	**883.9**	**955.7**	**71.8**
Quasi Money	**584.8**	**666.3**	**692.0**	**731.9**	**39.9**
Time Deposit in Rupiah	292.0	340.9	359.8	350.9	-8.9
Saving Deposit in Rupiah	152.6	170.7	191.7	241.8	50.1
Deposits in Foreign Currency	140.2	154.8	140.5	139.2	-1.3
Factors Affecting M2	**747.0**	**844.1**	**883.9**	**955.7**	**71.8**
Net Foreign Assets	**210.7**	**234.0**	**250.7**	**271.8**	**21.1**
Bank Indonesia	201.2	192.6	212.4	225.9	13.5
Commercial Bank	9.5	41.4	38.3	45.8	7.5
Net Domestic Assets	**536.3**	**610.1**	**633.2**	**683.9**	**50.7**
Net Claims on Central Government	**520.3**	**529.7**	**510.4**	**479.0**	**-31.4**
Bank Indonesia	133.7	160.8	168.5	173.3	4.8
Commercial Bank	386.6	368.9	341.8	305.7	-36.1
Claims to Business Sector	**294.9**	**329.9**	**389.3**	**466.8**	**77.5**
Total Credit	269.0	307.6	365.4	437.9	72.5
Credit in Rupiah	152.5	202.6	271.9	342.0	70.1
Credit in Foreign Currency	116.5	105.0	93.6	95.9	2.3
Other Claims	25.9	21.6	23.9	28.9	5.0
Others (Net)	**-278.9**	**-248.8**	**-266.4**	**-261.9**	**4.5**

Rp241.8 trillion at the end of year. For its part, the rupiah time deposits and foreign currency saving deposits decreased by Rp8.9 trillion and Rp1.3 trillion to Rp350.9 trillion and Rp139.2 trillion, respectively. The declined rupiah time deposits during 2003 was estimated to be related to the downward trend in the interest rate such that people tended to place their funds in a more flexible-short-term deposits. The positive development in the capital market also induced people to transfer a part of their funds to mutual funds (*reksadana*) and bond products.

Viewed by its affecting factors, M2 expansion mainly contributed by credit expansion and net international reserve. In the reporting year, net claims on business sector (NCB) rose Rp77.5 trillion, whereas NIR rose by Rp21.1 trillion. Net claims on government (NCG) contracted by Rp31.4 trillion due mainly to settlement of government bond principal, partial sale of recapitalization bonds to non-banks, and buyback of government bonds.

MONETARY POLICY TRANSMISSION

Transmission of monetary policy to the real sector through the interest rate channel was not fully effective due to the sluggish recovery in bank intermediation. At the same time, however, lower interest rate was effectively transmitted through the asset price channel. Owing to the low bank interest rate, some portion of public funds shifted away from conventional bank savings and deposits to stock market investment. This posted a rational behavior of the public to prudentially protect their net wealth. Increased asset prices, such as stock prices in particular, would in turn raise the capital market investors' net wealth. This condition has greatly triggered the issuance of corporate stocks and bonds in financing their business expansion.

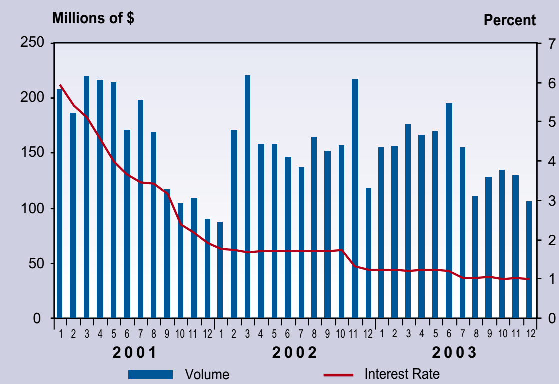


Chart 5.15. Foreign Exchange Interbank Money Market

Interbank Money Market (PUAB)

During 2003 the interbank money market was quite liquid as reflected in the falling PUAB rates in line with rates on monetary instruments, in particular the FASBI rate. The PUAB transaction volume, one indicator of bank liquidity, exhibited decreased growth rate of minus 2.1% in 2003 as against positive 18.2% in the previous year. The interbank money market development in 2003 reinforced the indication of increased bank excess liquidity of which banks were no longer in need of huge additional funds through the interbank money market transactions.

Average O/N interbank money market as recorded in the morning and afternoon clearings declined significantly, albeit with different magnitudes. Average interest rate in the morning and afternoon sessions declined by 424 bps and 332 bps over 2002, reaching 8.18% and 4.82% at the end of 2003 (Chart 5.14). Meanwhile, average interest rate in the foreign currency interbank money market also declined, but by a smaller magnitude of 27 bps to reach 0.98%. (Chart 5.15).

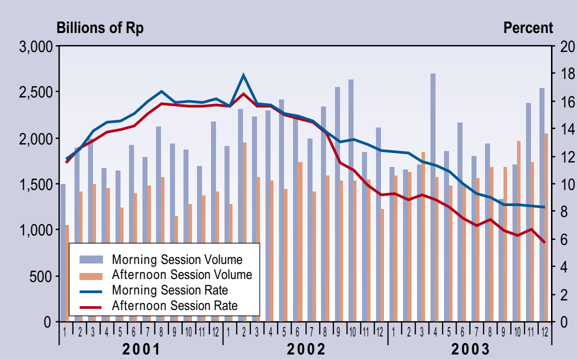


Chart 5.14. Value and Rupiah Interbank Money Market Rates

In 2003, the average daily volume in the rupiah interbank money market transactions, both in the morning and afternoon sessions were somewhat lower than last year. The decline was mainly due to decrease in morning average transaction volume of Rp0.3 trillion to become Rp1.9 trillion in 2003. Meanwhile, the average transaction volume in the afternoon session slightly increased to Rp1.7 trillion, up from Rp1.5 trillion in 2002. The shift in banks' transactions from the morning to the afternoon session occurred after the abolishment of FASBI of 2- to 7-day tenor.

Meanwhile, the average daily volume of foreign currency transactions in the interbank money market during 2003 was relatively stable without significant drop relative to a declined volume of $8.6 million to $148.7 million in 2002.

Viewed by group of players in the rupiah interbank money market, state banks, foreign exchange national private commercial banks (BUSD) and non-foreign exchange national private commercial banks (BUSND) remained the dominant lenders in the morning and

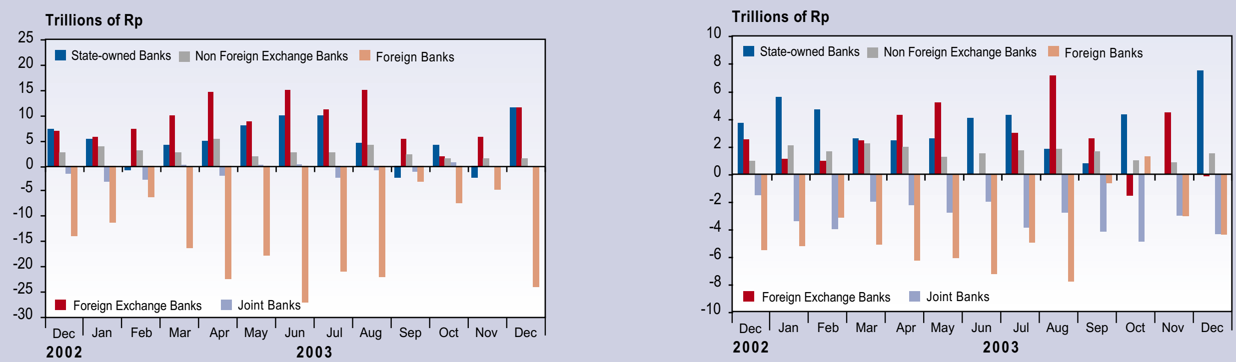


Chart 5.16.
Borrower and Lender in the Morning and Afternoon Sessions

afternoon sessions (Chart 5.16). This indicates highly liquid condition of the concerned bank groups, although not all banks in each group experienced excess liquidity. Several factors causing high liquidity in these groups were related to receipt of fund originating from recapitalization bond coupons and third party deposits. Meanwhile, foreign and joint venture banks were consistently net borrowers in both sessions of the interbank money market.

A slightly different situation occurred in foreign currency interbank money market in which BUSD were dominant net lenders while other bank groups served as net borrowers (Chart 5.17). That sort of condition was indifferent from that occurring in 2002, with state banks as dominant net borrowers.

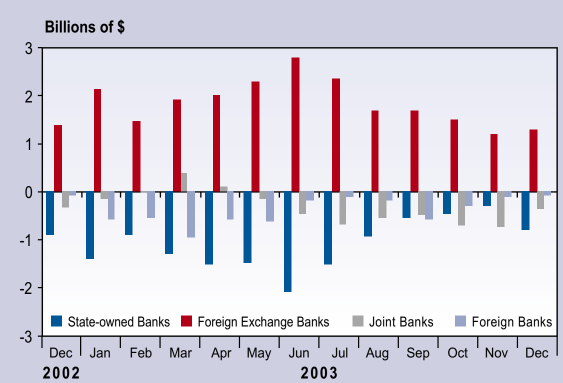


Chart 5.17.
Net Lender and Borrower
in the Foreign Exchange Interbank Money Market

Deposit and Credit Interest Rate

Bank deposit interest rates in 2003 moved with the downward trend in the monetary instrument interest rates. During 2003 the weighted average of 1-month bank deposit interest rate fell by 619 bps, reaching 6.62%.. The 3-month deposit interest rate decreased by 649 bps to 7.14%. The decrease was sharper compared to 1- and 3-month SBI rates, which in the same period decreased by 462 bps and 478 bps, respectively. Such situation has made deposit interest rate lower than SBI rate in 2003 (Table 5.4).

Several factors contributed to the lowering deposit interest rates in 2003 included increased banks' excess liquidity, falling monetary instrument interest rates, and narrowing margin of the deposit guarantee interest rate by 200 bps to zero bps. The 1- and 3-month deposit guarantee interest rate has decreased quite sharply, respectively by 757 bps and 766 bps, to reach 6.76% and 6.78% compared to 2002.

Declining deposit interest rates were followed by falling credit interest rates, albeit at a slower pace. Compared to deposit interest rate reduction of around 450-650 bps, decreased credit interest rate was around 100-300 bps. Working capital credit (KIM) interest rate was recorded at 15.07% at the end of 2003 or down 318 bps from the previous year (Chart 5.18). Investment credit (KI) interest rate also declined by 214 bps to 15.68%,

Table 5.4.
Developments of Interest Rates 2003

(Percent)

	2001 December	2002 December	2003 March	2003 June	2003 September	2003 December	Annual Changes
SBI							
1-month	17.62	12.93	11.40	9.53	8.66	8.31	-4.62
3-months	17.63	13.12	11.97	10.18	8.75	8.34	-4.78
BI Deposit Facility (FASBI)							
O/N morning	15.13	12.13	11.50	9.75	8.50	8.00	-4.13
O/N afternoon 1)	-	6.06	6.06	5.25	4.25	4.00	
2-6 days 2)	15.29	12.38	-	-	-	-	-
7 days 2)	15.88	12.50	-	-	-	-	-
Interbank Money Market (PUAB)							
PUAB O/N morning	15.52	12.42	11.52	9.71	8.52	8.18	-4.24
PUAB O/N afternoon	15.66	8.14	12.70	8.56	4.91	4.82	-3.32
PUAB O/N foreign currency	1.73	1.25	1.19	1.18	1.02	0.98	-0.27
Guaranteed Interest Rate							
1-month time deposit	17.88	14.33	13.86	12.95	8.86	6.76	-7.57
1-month time deposit	18.04	14.44	13.95	12.90	8.88	6.78	-7.66
PUAB rupiah	15.69	12.72	12.23	10.86	9.05	8.32	-4.40
PUAB foreign currency	2.05	1.31	1.21	1.21	0.98	0.97	-0.34
Time Deposit							
1-month							
- Counter rate	13.80	12.23	11.38	10.04	7.62	6.60	-5.63
- Weighted Average (LBU)	16.07	12.81	11.90	10.31	7.67	6.62	-6.19
3-months	17.24	13.63	12.90	11.55	8.58	7.14	-6.49
6-months	16.18	13.79	13.22	12.21	10.47	8.25	-5.54
12-months	15.48	15.28	14.16	12.93	11.90	10.39	-4.89
Credit							
Working Capital	19.19	18.25	18.08	17.41	16.07	15.07	-3.18
Investment	17.90	17.82	17.85	17.43	16.53	15.68	-2.14
Consumption	19.85	20.21	20.12	19.73	19.33	18.69	-1.52

1) O/N afternoon implemented per November 25, 2002
2) Removed by February 2003

whereas consumption credit (KK) interest rate declined the least by 152 bps to 18.69%.

As was the case in 2002, the slow pace of credit interest rate decline was still due to several internal and external banking factors. Internal factors were mainly related to banks' asset structure and financial performance, including banks' profitability, liquidity ratio, cost of loanable funds, and capital adequacy ratio (CAR). External factors were related to national and international economic development, bank competitiveness, alternative investment earnings, and banking regulations.

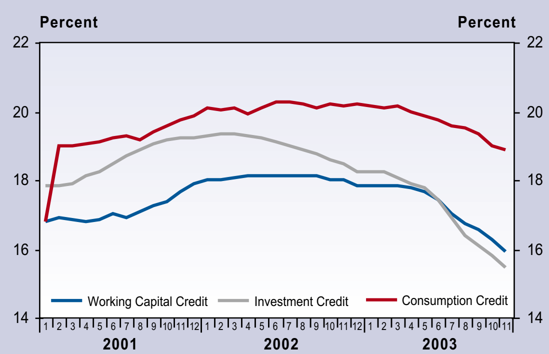


Chart 5.18.
Bank Credit Interest Rate

Viewed by fund structure, there was an indication that banks had limited ability to provide fresh long-term credit because mobilized bank deposits was dominated by short-term funds (Chart 5.19). Limited capacity of banks to provide credit was one of the indications that the intermediation function has not yet fully recovered, which eventually disrupted the smooth transmission of monetary policy through the interest rate channel.

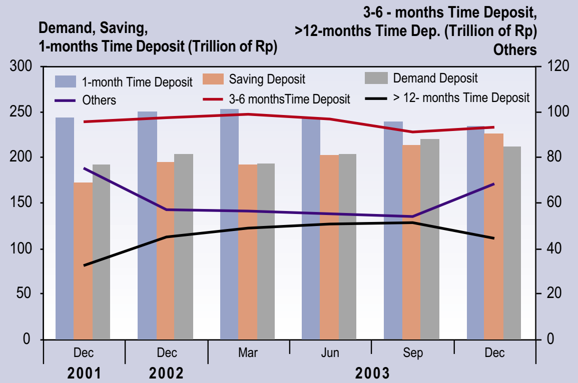


Chart 5.19.
Structure of Bank Assets

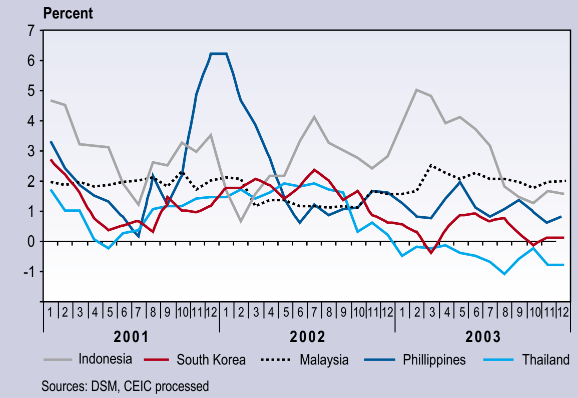


Chart 5.21.
Real Deposit Interest Rates in Several Countries

Real interest rates (Chart 5.20), both the monetary instrument interest rate and bank deposit interest rate, initially increased in 2003. However, as the decline in nominal interest rate was sharper than that the inflation rate, the real interest rate of monetary instrument and bank deposit tended to decline. Throughout 2003, the overall real interest rate of 1- and 3-month SBI decreased 35 bps and 19 bps, respectively; reaching 3.25% and 3.28% over 2002. Bank real interest rate on 1- and 3-month deposits also decreased to 1.56% and 2.08% respectively, or lower 122 bps and 152 bps than previous year.

Despite the decline, Indonesia's deposit real interest rates remain higher than those of other countries in Asia such as Korea, Thailand, and the Philippines (Chart 5.21).

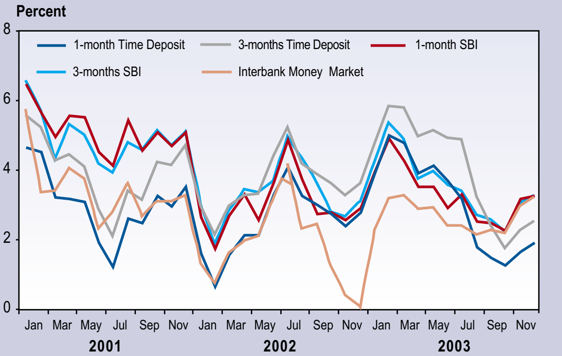


Chart 5.20
Real Interest Rates

At the end of 2003, Indonesian deposit real interest rates were still in the range of 2%. This margin was expected to maintain fund owners' interest in bank deposits.

Capital Market

The decline in the interest rate during 2003 has become one of the main impetus to the performance of the Indonesian capital market. This was reflected in the increased price and volume of trading in the stock market, bond market, and mutual funds. Several factors boosting the positive performance of capital market in Indonesia in 2003 were as follows:

1. Relatively low bank interest rate, which eventually enable the capital market to gain higher profit than bank deposits .
2. Improved foreign investors' perception on Indonesia's country risk and a significant interest rate differential that triggered capital inflows to gain short-term profits.
3. Macroeconomic stability and favorable growth prospect amid the global sluggish economy inducing foreign investors to shift attention to Indonesian capital market.

Positive performance has induced reputable corporations to seek financing sources from the capital market. Increased financing through stock and bond issues was one of the consequence of slow intermediation recovery, in addition to ineffective impact of lower interest rate on new credit expansion.

In line with exchange rate appreciation and lower bank deposit interest rate, the performance of the Jakarta Stock Exchange (JSE) in 2003 recorded the highest position since the crisis period. This was reflected by increased Jakarta Composite Index (JCI) in response to increased stocks trading both by domestic and foreign players. The number of issuers in the stock bidding in 2003, both upon Initial Public Offering (IPO) and right issue, was 9 and 11 companies, respectively with a total issuance value of Rp7.5 trillion for IPO and Rp2.5 trillion for rights issue.

Since the beginning of 2003 JCI tended to rise before finally being closed at level 691.9 or up by 266.9 (Chart 5.22). This increased JCI gained a profit of 62.8% as against the position at end 2002. Positive performance also occurred upon index LQ-45 which increased 59.9 to 151.9 in 2003 compared to the end position of previous year. The improved JCI and LQ-45 performance was closely related to several international stock exchanges positive performance and low bank interest rate.

In line with upward JCI, other stock exchange indicators also showed significant increase. Market capitalization increased by Rp191.9 trillion (71.5%) to Rp485.7 trillion at the end of 2003. Meanwhile, average daily volume of stock trading also increased, i.e. from 698.4 million shares in 2002 to 953.6 million shares. Along with the increased number of shares traded, trade value also increased. Average daily trade value in 2003 was recorded Rp507.8 billion, increasing by Rp492.9 billion as against previous year (Chart 5.23)

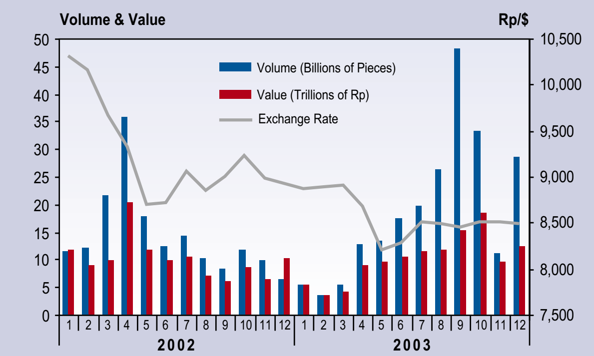


Chart 5.23.
Trade Value and Volume

Positive development of the JSE was initially driven by foreign participations followed then by domestic investors as indicated by the co- movement between foreign net purchases with the JCI performance (Chart 5.24). Net foreign purchases increased significantly since mid 2003 and even peaked at Rp2.5 trillion in December 2003. On the average annual basis, net foreign purchases increased substantially to Rp823.3 billion as against Rp260.7 billion in 2002.

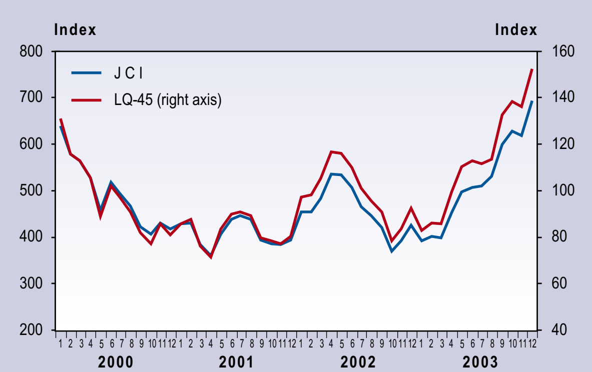


Chart 5.22.
Development of Composit Index and LQ45 Index

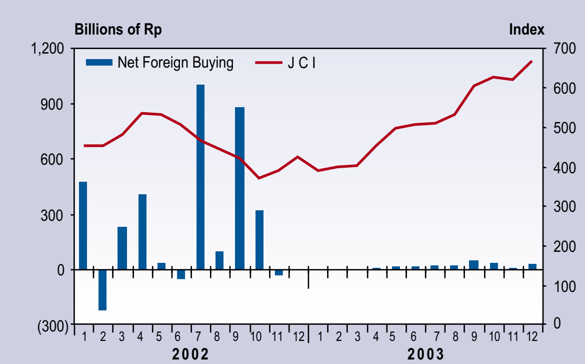


Chart 5.24.
Net Foreign Buying/Selling

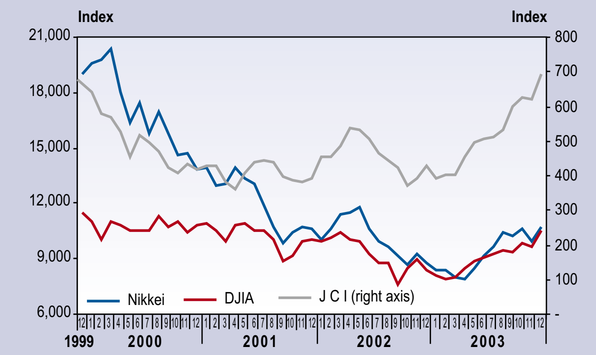


Chart 5.25.
Stock Index Movement in Several Bourses

In global context, improved global economy forecast has boosted index performances of some international stock exchanges (Chart 5.25). Dow Jones Index as one of referential stock exchanges for global investors increased remarkably in 2003 and reached its peak level ever since. During 2003 Dow Jones Index reaped an increase of 2,150.1 or 25.9%, from 8,303.8 in end December, 2002 to 10,453.9 and is considered to be the early sign of global economic recovery, particularly in the United States. Against this perception, investors are expecting higher capital gains next year which in turn would raise stock prices. In line with improving global condition, Nikkei index in Japan Stock Exchange also increased, reaching 10,676.4 at the end of 2003 as against 8,714.5 in 2002 or increased by 1,962.4 (22.5%).

Similarly, **bond markets**, both government and private bonds, exhibited significantly increased activities. This was reflected from increased number of bond issues in primary markets and increased trade volume in secondary markets. Bond issues have become a cheaper alternative source of financing for corporations instead of bank loans. Additionally, it was used as source to finance state budget deficit, to cover government cash flow mismatch and to manage government debt portfolio.

During 2003 **government bond market** exhibited increased activities compared to previous years. In its development, government bonds became the driving force of all transaction activities in both primary and secondary bond markets. In 2003, the government issued bonds four times, of which one was the re-opening of the FR0024 series. The total bonds issued was Rp12.4 trillion and the coupons was in the range of 11%-12% with yield spread between 11.60%-13.05% (Table 5.5).

The development of government bonds remained dominant, followed by FR bonds and hedge bonds throughout the years (Table 5.6). Based on portfolio type, during 2003 investment bond segment declined significantly to 52.9% as against 72.2%, whereas tradable bond segment increased from 23.8% to 47.1%.

Viewed from frequency and volume, during the review period the monthly government bond trading exhibited significant increase (Chart 5.26). Average volume of government bond trading in 2003 was Rp28.1 trillion/ month as against Rp10.6 billion/month in the previous year. Meanwhile, its average trade frequency was 1,029 times/ months as against 332 times/month in the previous year.

In line with the increased activities in government bond markets, private corporation bond market also recorded positive development. Surabaya Stock Exchange (BES), as the centre of private bond trading recorded a significant increase in bond issues. Private bond issues listed

Table 5.5.
Government Bond Issues 2003

Item	FR0022	FR0023	FR0024	FR0024 1)
	Trillions of Rupiah			
Indicative Target	2,700	5,000	2,500	2,500
Bidding	8,047	4,700	5,418	6,434
Winner	2,7000	3,996	2,500	3,200
Yield Average (%)	12.21	11.60	12.92	13.05
Characteristics :				
- Coupon (%)	12.00	11.00	12.00	12.00
- Maturity	15 -9-2011	15-12-2012	15 -10-2010	15-10- 2010
- Tenor	8 year 6 month	9 year 3 month	7 year	7 year

Note : 1) Re-opening series by December 2003

Table 5.6.
Development of Government Bonds

(Billions of Rp)

	2001	Share (%)	2002	Share (%)	2003	Share (%)
Based on Type	**435,303**	**100.00**	**419,357**	**100.00**	**403,441**	**100.00**
Fixed Rate	175,464	40.31	154,456	36.83	159,039	39.42
Variable Rate	219,479	50.42	239,602	57.14	231,443	57.37
Hedge Bond	40,360	9.27	25,299	6.03	12,959	3.21
Based on Portfolio	**435,303**	**100.00**	**419,356**	**100.00**	**403,412**	**100.00**
Investment	370,649	85.15	319,643	76.22	213,515	52.93
Tradeable	64,654	14.85	99,713	23.78	189,897	47.07
- Available for Trade	61,184	14.06	99,713	23.78	189,897	47.07
- Collateralized	3,470	0.80	0,000	0.00	0,000	0.00
Based on Ownership	**435,304**	**100.00**	**419,356**	**100.00**	**403,441**	**100.00**
Ministry of Finance	0,878	0.20	0,873	0.21	0,000	0.00
Recap Bank	396,631	91.12	359,872	85.82	307,364	76.19
Non-Recap Bank	24,773	5.69	13,829	3.30	27,240	6.75
Sub-Registry	13,022	2.99	44,782	10.68	68,837	17.06

57 issuers, increasing from 35 issuers in 2003. The total issuance value in 2003 comprised of rupiah bonds amounting to Rp25.0 trillion, *syariah* bond Rp0.7 trillion, and dollar bonds \$0.1 billion. Against this backdrop, bond capitalization in BES increased by Rp19.7 trillion to Rp45.4 trillion at the end of 2003. In addition to issuing bonds domestically, during 2003 there were also some banks and non-banks issuing bonds abroad with a total value of \$2.0 billion.

As was the case with stock and bond markets, mutual funds (*reksadana*) market (see mutual funds (*reksadana*) development in Chapter 8) also developed

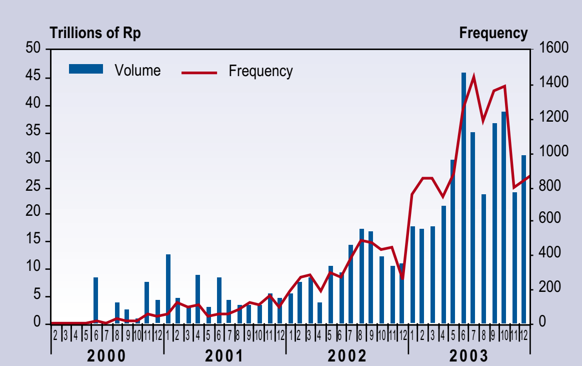


Chart 5.26.
Government Bond Volume and Trade Frequency

remarkably in 2003. Growth in mutual funds was higher than that of banking deposits. However, on the nominal basis, the outstanding mutual funds was still lower than bank deposits. To some extent, mutual funds became an alternative financial instrument that could bridge the intermediation process from the capital market to the real sector. Hence, growth in mutual funds would indirectly trigger the real sector development. On the contrary, mutual fund could lead to unwanted bubbles in its underlying assets market. Consequently, the mutual fund development should be monitored closely in such away no to disrupt the financial system stability.

The crucial thing to maintain its sustainability is the establishment of liquid secondary market supported by transparency and prudent regulations by the Bapepam and Bank Indonesia[4] The development of liquid secondary market is indispensable so as to ensure investors' confidence in mutual fund investment and in turn ensure the smooth redemption of mutual funds. Meanwhile, to improve transparency and regulations, Bapepam needs to promptly streamline prudential regulations in this area.

4 The mutual fund transactions involve several market players such as fund managers and banks under supervision of two different institutions, i.e., Bapepam and Bank Indonesia.

Box Chronology of SBI and FASBI Interest Rates Declines in 2003

During 2003, interest rates on monetary instruments (1- and 3-month SBIs and FASBI discount rates) declined significantly.

In general, the movement in interest rates is driven by the interaction between demand and supply of funds in the markets. Recently, the declining interest rate is mainly due to banks' excess liquidity supported by Bank Indonesia's policy to influence banks to reduce their loan rates. This policy is intended to provide conducive signals for the economic recovery and is expected to enable banks to improve intermediation.

FIRST QUARTER (JANUARY-MARCH, 2003)

The continued decline in inflation and base money below its indicative target during this quarter were the main considerations in Bank Indonesia lowering SBI rates. During this quarter, rates on 1- and 3-month SBIs declined by 153 bps and 115 bps, respectively.

The slight depreciation (a reversal from QIV-2002) accompanied by higher volatility in the exchange rate did not hamper the rapid decline in interest rates. This was mainly contributed by inflows of currency into the banking system and interest earnings from Open Market Operations (OMOs). The absorption of liquidity through OMOs (SBI and FASBI) increased by Rp14.6 trillion. During this quarter, the FASBI rate was lowered by 62.5 bps to 11.5%.

The auction signal which tended to be neutral bias amid excess liquidity (as reflected in persistent SBI over-subscription) sharply reduced the concentration of bid rates from mid-February up the end of March.

SECOND QUARTER (APRIL-JUNE 2003)

Continued declines in inflation, controlled expansion of base money and a strengthening exchange rate supported further interest rate declines. In addition, liquidity expansion in the banking system, mainly driven by drawdowns of the government's account at Bank Indonesia, largely determined banks' desire to place their excess liquidity into SBIs, especially when intermediation had not recovered.

A higher FASBI than 1-month SBI rates was corrected 6 times during this quarter. A total correction of 175 bps caused the FASBI rate to fall to 9.75% by the end of June. The 1-month SBI rate declined by 187 bps whereas the 3-month SBI rate by 178 bps.

Declining rates were perceived by the market as a sign of further declines. This signal is partly reflected in (1) a neutral bias in the SBI auction amid over-liquid market conditions; (2) a low ratio of action winners; (3) a sharp decline of interest rates from week to week, perceived by the market as central bank confirmation of expected further declines; and (4) a significant drop in FASBI rates.

THIRD QUARTER (JULY-SEPTEMBER 2003)

An increase in annual inflation, a base money running above its target and the weakening tendency of the exchange rate during the first two months of the quarter were Bank Indonesia's main considerations in slowing the reduction of interest rates.

The decision to accept a higher ratio of auction winners resulted in a further concentration of bid rates; they were quite stable within a narrow range. As a result, the decline in 1-month SBI rate was only 87 bps, while 3-month rates dropped by 143 bps. For the same period, the FASBI rate declined twice in July and August by 125 bps, reaching 8.5% at the end of September.

FOURTH QUARTER (OCTOBER-DECEMBER 2003)

The SBI auction target during QIV continued to be adjusted in line with maturing SBI volumes. During October, the bidding volume was higher than targeted, whereas in November and December bidding volume were relatively low due to a higher demand of currency in advance of the religious festivities and year-end. The constant ratio of auction winners near 100% was considered quite optimal in slowing the interest rate decline.

By the end of QIV-2003, the decline in 1-month SBI rates had been only 35 bps, whereas that of 3-month was 41 bps. Meanwhile, FASBI rates were lowered twice each by 25 bps, bringing the FASBI rate down to 8.0% by the end of December.

Box Resolution of the BLBI Issue By the Government and Bank Indonesia

After almost five years, the Government and Bank Indonesia have agreed to settle the controversial issue of Bank Indonesia Liquidity Support (BLBI), following approval from the House. This controversial issue came to an end on August 1, 2003 through a resolution that places no additional financial burden on the State Budget (APBN) or on Bank Indonesia.

Pursuant to the House decision of July 3, 2003 and The Agreement of August 1, 2003 between the Government and Bank Indonesia, BLBI issues have been completely settled. The financial relationship between the Government and Bank Indonesia concerning BLBI has returned to normal after differences in perceptions of the BLBI issues were resolved.

The tangled history of BLBI and its polemics are fully solved by the House's decision of July 3, 2003. This stipulates that the policy on BLBI constitutes a government policy decision implemented through Bank Indonesia with a view to safeguarding the monetary and banking system as well as the economy as a whole.

POLITICAL DECISION ON BLBI SETTLEMENT

Prior to the Agreement of August 1, 2003 efforts had been made by the Government and Bank Indonesia concerning the BLBI settlement as seen in the Agreements of November 17, 2000 and June 11, 2002. However, these agreements failed due to the lack of political endorsement from the House after objections by the Supreme Audit Board (BPK) to the draft settlement proposed by the Government and Bank Indonesia.

In light of BPK's objections, the Government and Bank Indonesia proposed a revised solution. Through a series of intensive discussions, on July 3, 2003 Commission Nine of the House, the Government, Bank Indonesia and IBRA agreed to six political decisions concerning the BLBI settlement, as follows:

1. Pursuant to BPK's audit, it was declared that decision to extend BLBI during the crisis period constitutes a policy commitment formulated by the Government together with Bank Indonesia. This policy commitment was then undertaken by Bank Indonesia with a view to safeguarding the monetary and banking system as well as the economy as a whole.
2. The BLBI settlement as verified by BPK's audit is Rp144.5 trillion. The remaining Rp14.5 trillion is to be resolved during the subsequent BPK audit.
3. To relieve the burden on the State Budget (APBN) and Bank Indonesia's Balance Sheet, the outstanding BLBI are to be replaced by government securities.
4. To achieve an optimal recovery rate on the BLBI settlement, harmonious cooperation between the Government (including IBRA) and Bank Indonesia is to be undertaken.
5. As regards legal matters arising from suspected violations in the channeling, receipt and use of BLBI, prompt legal action shall be taken.
6. The Government and Bank Indonesia are to follow-up on this decree with a formal agreement within 30 (thirty) days from the date of issue of this decree.

This political decision constitutes the policy patronage to other related parties, particularly to the Government and Bank Indonesia. Considering the APBN capacity and the condition of BI's balance sheet, the Government and BI were to discuss the technical aspects of the settlement for a maximum period of 1 (one) month.

THE AGREEMENT BETWEEN THE GOVERNMENT AND BANK INDONESIA ON AUGUST 1, 2003

Following the House's political decision of July 3, 2003, on August 1, 2003 the Government and Bank Indonesia signed a "Mutual Agreement concerning the BLBI Settlement and the Relationship Between State Budget Operation and Bank Indonesia." The agreement includes the following points:

1. The BLBI scheme constitutes government policy formulated together with Bank Indonesia during the crisis period. The decision was aimed at rescuing banks from default and maintaining monetary and overall economic stability. This settlement will take into account budget capacity and Bank Indonesia's financial sustainability.
2. The agreed amount of BLBI settlement was Rp144.5 trillion; the remaining Rp14.5 trillion is to be settled later. To solve the BLBI settlement, new government securities (SUN) No. SRBI-01/MK/2003 were issued. These replaced the old securities (No.SU-001/MK/1998 and SU-003/MK/1999). The new SUN are to be effective as of August 1, 2003, without indexation, of 30 years maturity and they can be rolled over. This security bears an annual coupon of 0.1% and is to be held by Bank Indonesia until the end of its maturity period.
3. In return for holding these SUN securities, reference is made to a 3%-10% range in the ratio of BI's capital to its monetary liabilities. If this ratio exceeds 10%, financing is to be paid from BI's surplus to the government. If the ratio falls below 3%, the Government is to pay financing to BI in order to reach the 3% ratio. The credited balance in favor of BI is to be classified as BI receipts other than capital injections.
4. With issuance of these SUN to settle BLBI, the previously issued government IOUs worth of Rp144.54 trillion and the Bank Indonesia's IOU worth of Rp24.5 trillion are declared to be terminated. The interest burden and securities indexation that have been paid by the Government and/or Bank Indonesia are not to be reclaimed and are classified as assets to both receiving parties. For its part, unpaid interest and indexation are no longer to be claimed by Bank Indonesia and/or the Government.
5. Bank Indonesia is to be classified as a non-tax payer, and any positive balance in government's current account at Bank Indonesia will be free of interest.
6. With this agreement in place, the previous agreements of November 17, 2000 and of June 11, 2002 are revoked and declared invalid.

RP14.5 TRILLION BLBI SETTLEMENT

Under the BLBI settlement agreement of August 1, 2003, the acknowledged outstanding BLBI extended prior to January 29, 1999 was Rp144.5 trillion. This amount has been verified by the Supreme Audit Board (BPK RI). This acknowledged figure was smaller than the total BLBI of Rp159 trillion for which BI had sought settlement. Consequently, the remaining balance of Rp14.5 trillion was to be settled later by the Government and BI. This settlement, however, was suspended mainly due to undetermined verification by BPK.

The outstanding Rp14.5 trillion had been extended as support to banks by debiting their current balances. This included banks under IBRA, banks under the recap program and banks under special surveillance (Bank Dalam Penyehatan-BDP). The implementation of the support program was conducted from January 29, 1999 up to May 14, 1999. The funding for this program should have been taken out from the government budget considering that this decision constitutes a government policy commitment. However, due to the budget's limited capacity, the funding to certain banks was undertaken by Bank Indonesia.

To reclaim those funds, a BI memo No.2/16/DG/BKr of July 14, 2003 (concerning the debited amount of Rp14.5 trillion on government treasury account 502) was sent to the Minister of Finance. This memo elucidates a temporary shifting of the debited 502 account into a BI transitory account. This temporary shift was undertaken based on BPK's recommendation as stated in the audited BI 1999 Financial Report of July 14,2000. However, during the BLBI discussion forum on July 31,2003 between BI and the Government, it was decided that the burden of the Rp14.5 trillion would be born by Bank Indonesia. To clarify this matter, a memo was sent by the Minister of Finance to Bank Indonesia, proposing that the Rp14.5 trillion be re-credited to treasury account 502.

Shortly after this memo was sent, BPK through its audit of August 25,2003 declared that debiting Rp14.5 trillion from treasury account 502 is considered legally incorrect. BPK is of the opinion that the BLBI burden should not be debited from the treasury account 502. On this basis, Bank Indonesia argued that debiting the 502 treasury account was conducted on the basis of authorization from the Minister of Finance. Hence, it did not conflict with the legal position of BPK.

In parallel, the increasing need to repay external debt under Exchange Offer II, has prompted the Minister of Finance to request Bank Indonesia to credit the Rp14.5 trillion back into the 502 treasury account. Upon this request, Bank Indonesia is of the opinion that crediting the 502 account should be initially endorsed by BPK audit and approved by the House. Against this background, on November 16, 2003 the House invited both the Minister of Finance and Bank Indonesia to discuss this issue thoroughly. Eventually, it was declared that the Rp14.5 trillion BLBI burden should be borne by Bank Indonesia. Based upon this decision, Bank Indonesia was requested to re-credit the 502 treasury account, closing the Rp14.5 trillion BLBI controversy.

Chapter 6:
Balance of Payments

Chapter 6: Balance of Payments

Indonesia's balance of payments in 2003 continued to record a significant surplus contributing to the increase in foreign exchange reserves. Meanwhile, several indicators of foreign debt experienced an improvement.

During 2003, Indonesia's balance of payments (BOP) developed favorably. Overall balance of payments recorded a significant surplus coming from the surplus in the current account that was much higher than the deficit in the capital account. This was contributed by stronger export performance compared to the previous year. Meanwhile, the capital account deficit slightly widened as a result of the increase in foreign debt repayment by both the government and private sector. With a surplus of $4.2 billion, Indonesia's international reserves at the end of 2003 increased to $36.2 billion or equivalent to 7.1 months worth of imports plus official foreign debt repayment (Table 6.1). The level of international reserves was the highest ever in Indonesia.

Table 6.1
Indonesia's Balance of Payments

(Millions of $)

Items	2001	2002R	2003*
I. Current Account	**6,901**	**7,823**	**7,709**
1. Goods Account	**22,695**	**23,512**	**24,438**
a. Exports f.o.b	57,364	59,165	63,450
b. Imports f.o.b	-34,669	-35,653	-39,011
2. Services (net)	**-15,795**	**-15,690**	**-16,729**
II. Capital Account 1)	**-7,617**	**-1,102**	**-1,656**
A. Public Sector	**-99**	**-190**	**-598**
B. Private Sector	**-7,518**	**-912**	**-1,059**
1. Direct Investments	-2,977	145	-955
2. Portfolio Investments	-244	1,222	2251
3. Others Investments	-4,296	-2,279	-2,355
III. Total (I&II)	**-717**	**6,721**	**6,053**
IV. Errors and Omissions (net)	**714**	**-1,694**	**-2,446**
V. Monetary Movement	**3**	**-5,027**	**-3,606**
Changes in Reserves Assets 2)	**1,378**	**-4,021**	**-4,209**
IMF	**-1,375**	**-1,006**	**603**
Notes:			
1. Reserve Assets	28,016	32,037	36,246
In Months of Imports and Official Debt Repayment	5,9	6,6	7,1
2. Current Account/GDP (%)	4,7	4,5	3,8

1) After taking into account foreign debt rescheduling
2) Minus (-) : Surplus and Vice Versa

On the current account side, the increase in export earnings was triggered by price increases of both oil/gas and non-oil/gas export commodities in international market, while the growth of export volume was still relatively low. Low export volume was mainly experienced by the non-oil/gas sector as a result of the increasingly tight competition in the international market and low economic growth in Indonesia's major trading partners. Government has made various efforts to stimulate non-oil & gas export performance, but the results were less than expected. Such efforts included, among others, improving market access by conducting export promotion and market penetration especially in non-traditional countries,[1] improving competitiveness of export commodities, utilizing a counter trade scheme, reducing import duties of certain components expected to raise investment and reduce production cost,[2] as well as policies in the investment area in the form of simplification of licensing process by providing one stop service. Exporters

1 Decree of the Minister of Industry and Trade No. 517/MPP/Kep/8/2003 concerning Duties and Functions of Attaché/Head of Division of Industrial and International Trade dated August 28, 2003

2 Decree of the Minister of Finance No. 381/KMK.01/2003 dated September 3, 2003 concerning the Exemption of Import Duty on Raw Materials/Components Needed to Produce Telecommunication Equipment and Network by Telecommunication Industry.

considered some of the policies unconducive to export performance, such as, among others, overlapping policies between land use for mining and that for forest preservation, the policy to raise the cost of energy for industry, and increase in the loading /unloading costs at the port. This condition was made worse as some importing countries apply non-tariff barrier in the form of fulfillment of certain quality and health standard requirements for some Indonesian primary export commodities. Meanwhile, several structural problems such as those of labor, security, and law enforcement still hampered the performance of non-oil and gas export performance.

The value of non-oil/gas imports in the reporting year was higher than that in the previous year. This was in line with the increasing domestic consumption and production. Non-oil/gas imports also experienced an increase, although import grew slower than exports. The increase was accounted for the rise in both domestic consumption of fuel and oil prices in the international market.

In the reporting year, the services account recorded a larger deficit than in the previous year. This was due to both lower receipt from tourism and higher cost for freight along with stronger import growth. However, several components in the services account experienced an improvement such as, an increase in foreign exchange received from Indonesian overseas workers, a decrease in interest payments on government foreign debt, and a decreased spending on overseas transportation service.

The capital account recorded a wider deficit in both public and private balance. The deficit in public capital account particularly originated from the increase in government foreign debt payment due to declining amount of government foreign debts rescheduled through the Paris Club forum. Meanwhile, the widened deficit of the private capital account was stemmed from the increase in private foreign debt payment in line with the increased capability of the private sector to pay their debts resulted from both rupiah appreciation and successful debt restructuring. The widened deficit in private capital account also stemmed from the declining foreign investment in Indonesia in the form of both share and debt. On the other hand, short-term inflows in the form of portfolio investment recorded a significant increase originated from privatization of State-owned Enterprises through the stock market and supported by the reduction in the risk premium, availability of a variety of investment outlets, and still-attractive profit levels as well as better economic prospects.

CURRENT ACCOUNT

The current account in the reporting year was estimated to record a surplus of $7.7 billion (3.8% of GDP), slightly lower than in the previous year (Chart 6.1). The current account surplus reflected the net surplus between the balance of trade and the services account. Compared to the previous year, the trade surplus increased by 3.9%, while the deficit in the services account was up by 6.6%.

The rise in the trade surplus stemmed from higher increase in exports compared to imports, mainly taking place in the oil/gas sector. This was related to higher prices of crude oil/gas than in the previous year. In contrast, the balance of trade in the non-oil/gas sector recorded import growth greater than that of exports.

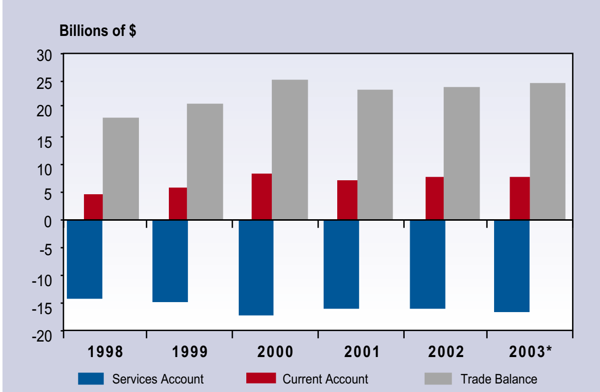


Chart 6.1
Current Account, Trade Balance, and Services Account

Exports

In the reporting year, overall export value was $63.5 billion, or a 7.2% increase compared to the previous year. The growth of export value stemmed from the increase in exports of non-oil/gas and oil/gas whose respective values were $47.9 billion and $15.5 billion, or an increase of 3.5% and 20.7% respectively (Chart 6.2).

Non-oil/gas exports in the reporting year were dominated by manufacturing sector, which contributed the largest share in the structure of non-oil/gas exports, followed by mining and agricultural sector. However, in value terms, the agricultural and mining sectors contributed the largest share to imports (Chart 6.3). Meanwhile, in volume terms, some major export commodities showed declining growth due to weakening competitiveness of textile and textile products and wood products. As a result, installed capacity in the two industries tended to decline.

In the agricultural sector, export value increased in comparison to the previous year, stimulated by price increases in the international market, while export volume was relatively stable. Price increases were due to the successful cooperation among the countries producing agricultural products in maintaining price stability. Exports of natural rubber served as the main driving factor behind the increase in the exports agricultural commodities (Table 6.2). The increase took place in both prices and volumes. The better price of natural rubber was due to the role of Tripartite International Rubber Cooperation (ITRCo) in regulating production volume and natural rubber export from the three main rubber-producing countries (Indonesia, Malaysia and Thailand). In order to continuously stabilize the price of rubber, the ITRCo was followed by the establishment of International Rubber Consortium Company in the 9th ASEAN Summit in 2003. In addition, rubber export volume also experienced an increase pushed by increased world demand for natural rubber, especially that coming from additional quota of natural rubber exports to China.

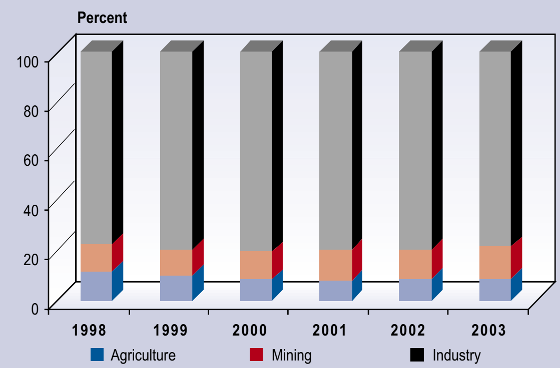


Chart 6.3
Development of Non-oil and Gas Exports

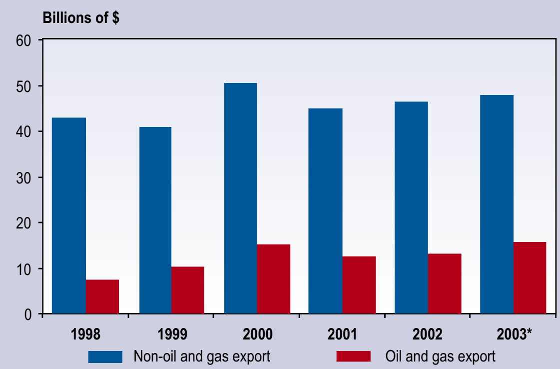


Chart 6.2
Oil and Gas and Non-oil/Gas Export Value (Net)

Table 6.2
Agricultural Goods Exports

Items	2002 Change (%)	2003* Change (%)	2003* Value (Millions of $)	2003* Share (%)
Animal & Animal Products	-4.6	0.9	1,444	3.0
- Shrimp	-13.2	5.0	787	1.6
Rubber	22.0	32.6	1,309	2.7
Coffee	31.5	3.4	219	0.5
Tea	11.3	-11.4	96	0.2
Papper	-26.4	-4.8	74	0.2
Leather	-14.8	7.3	74	0.2
Tobacco	-22.9	-2.2	72	0.1
Wood	-48.4	-12.0	48	0.1
Tapioca	-54.1	-51.8	3	0.0
Others	50.0	-3.8	854	1.8
Total	**9.8**	**7.3**	**4,191**	**8.7**

Export value of other agricultural commodities was relatively stable in 2003. Although export value of shrimp increased by 5.0%, the volume dwindled. This resulted from the high barriers to shrimp exports to Japan, the US and European Union. Shrimp exports to Japan, the largest market for Indonesian shrimp exports, were interrupted after the discovery of the anti-biotic substance *chloramphenicol* in shrimp imported from China so that the Japanese government tightened all shrimp imports, including those coming from Indonesia. The sluggish Japanese economy also contributed to the low demand for shrimp. The European Union also tightened its import policy on the anti-biotic free shrimp import policy before revoking it in September 2003.

The value of the coffee exports increased by just 3.4%. The low growth was due to the declining world price of coffee as the supply rose relative to the demand. The world coffee supply significantly increased with the entry of Vietnam, one of the largest coffee producers in the world after Brazil.

In the mining sector, export values recorded a higher growth mainly contributed by copper and coal exports (Table 6.3). The increase in copper exports was resulted from international price increases pushed by higher world demand relative to world copper supply. Meanwhile, coal exports also increased, pushed by the rise of world prices and volumes. Price increases of coal in the world market were due to reduced exports from China, whose products were allocated to domestic for industry so that Indonesia had the opportunity to increase its coal export volume.

Table 6.3
Exports of Mining Products

Items	2002	2003*	2003*	
	Change (%)		Value (Millions of $)	Share (%)
Copper	-3.0	19.0	2,789	5.8
Coal	14.8	11.1	2,480	5.2
Tin	11.7	11.9	307	0.6
Nickel	-82.6	328.4	222	0.5
Aluminium	7.0	-8.6	207	0.4
Other	-19.2	4.7	425	0.9
Total	**-1.5**	**16.2**	**6.431**	**13.4**

Export value of the manufacturing sector in the reporting year was higher than the previous year. However, the increase was mainly driven by price increases of several commodities in the international market. Most manufacturing products recorded a drop in export volume. Only some products experienced increases, including, palm oil, chemicals, and paper (Table 6.4).

The rise of exports in the industrial sector in 2003 was pushed by the growth of export value of several major commodities, namely, palm oil, chemicals, metal products and rubber products. The rise of palm oil export in 2003 was attributable to high world demand, ie specially from India, the Netherlands and China. The rise in export value was also due to abundant palm oil domestic supply originated from increased production. Meanwhile, the rise in exports of chemicals, metal products and rubber products was due to an increase in world demand.

Several main non-oil export commodities such as textile and textile products, wood products, electronics, and

Table 6.4
Exports of Manufacturing Products

Items	2002	2003*	2003*	
	Change (%)		Value (Millions of $)	Share (%)
Textile & textile products	-7.2	1.2	6,342	13.2
– Garments	-12.5	3.4	3,459	7.2
Electrical appliances	8.6	-5.3	6,290	13.1
Wood products	-1.7	-2.7	3,792	7.9
– Plywood	-9.4	-9.8	1,410	2.9
Machinery and Mechanical	5.0	-6.0	3,015	6.3
Chemical products	10.0	14.3	2,696	5.6
Palm oil	70.6	14.0	2,613	5.5
Paper	-8.1	4.0	2,558	5.3
Footwear	-6.1	-6.1	1,264	2.6
Metal products	-5.1	7.8	1,156	2.4
Plastics products	3.4	-1.4	1,045	2.2
Rubber product	21.7	10.6	578	1.2
Handicrafts	-4.1	-5.9	480	1.0
Glass and glassware	2.8	2.7	323	0.7
Rattan products	4.6	5.0	298	0.6
Cement	-34.0	-19.3	90	0.2
Copra oil-cake	39.5	-5.4	65	0.1
Others	5.3	5.5	4,702	9.8
Total	**3.5**	**1.2**	**37,306**	**77.8**

footwear recorded a decrease both in terms of value and volume. Textile and textile product exports decreased due to problems faced by producers such as aging machinery, limited sources of investment and the emergence of new competitors such as China and Vietnam. Meanwhile, the decrease in exports of wood products was due to the declining supply of raw materials because of the restrictions on wood logging under Decree Number 156/KPTS-II/2003 of the Minister of Forestry on Forest Conservation. Aside from the decree, the difficulty in obtaining raw material was also related to log smuggling abroad. In spite of restrictions on wood logging, illegal logging in practice continued. The decrease in export of electronics was linked to weak demand and limited additional production capacity. Similarly, footwear industry also experienced a decline. Several companies even have relocated their plants to other countries because of an unconducive business climate such as rising manpower cost, and other problems.

The destination of Indonesian non-oil/gas exports was still concentrated on three traditional markets (the US, Japan and Singapore). Despite its declining share, the US remained the largest non-oil & gas export destination, despite its declining share, followed by Japan whose market share increased slightly and followed by Singapore whose market share slightly declined (Chart 6.4). The decline in non-oil/gas exports to the US was due to the decrease of exports of several major commodities such as textile and textile products and electronics. As the share of Indonesian exports to the US was dwindling, the export share of countries such as China and Vietnam experienced an increase.[3] There were some indicators that Indonesia's export product competitiveness weakened compared to those of competing countries.

3 Concerning the US as importing country, the share of Indonesia's import showed a decline from around 1% (1996) to 10.8% and 0.4% respectively in the first semester of 200. Meanwhile, China and Vietnam increased from 6.5% and 0% respectively (1996) to 10.8% and 0.4% respectively in the first semester of 2003. Indonesia's import share to Japan dropped from 4.4% (1996) to 4.2% in the first semester of 2003, while China and Vietnam rose from 11.6% and 0.6% in 1996 to 18.8% and 0.8% in first semester of 2003, Sources: CEIC Data, November 2003 (processed)

Indonesian non-oil/gas exports faced significant challenges. These included not only the export structure that was still concentrated on traditional markets and commodities, but also the tight competition of other exporting countries in Asia. Indonesian oil/gas exports still largely depended on demand in the US, Japan, and Singapore, which reached about 40% of the total non-oil/gas exports. By commodity structure, non-oil/gas exports were still dominated by five major commodities, namely, textiles and clothing, wood products, electronics, machinery and copper (±40% of total non-oil/gas exports). The concentration on only a few markets made non-oil/gas exports vulnerable to downturns in commodity markets (Chart 6.5). Meanwhile, among primary non-oil/gas export commodities, only paper, copper, and dairy products did not have competitors in the Asian region (Table 6.5).

On the other hand, the export value of oil in the reporting year was $7.5 billion, increased $6.5 billion in the previous year. The increase was stemmed from the rise in oil prices in international market since the first quarter of 2003. The average price of crude oil exports in 2003 was $28.6 per barrel, increased $24.4 per barrel in the previous year. The price increase was partly triggered by the US - Iraq war which disrupted oil production in Iraq. The rising price was also prompted by disrupted oil production in Nigeria and Venezuela and decreasing oil

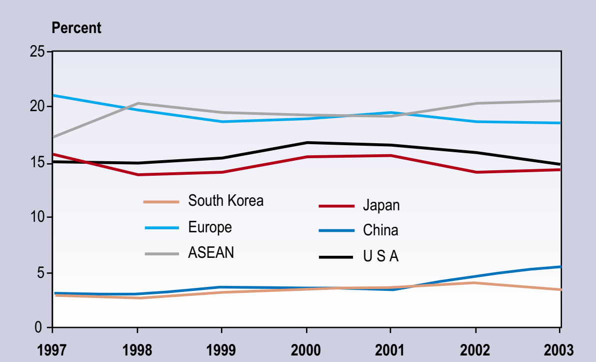


Chart 6.4
Non-Oil/Gas Import Share By Origin

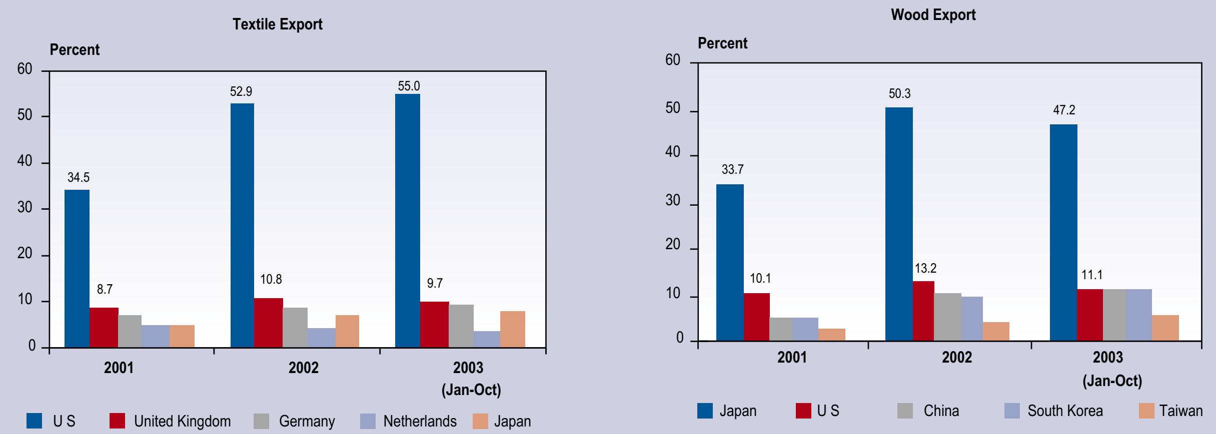


Chart 6.5
Textile and Wood Export By Origin

reserves in the US. Despite rising oil prices in the international market, Indonesia's oil production declined. In 2003, Indonesia's oil production dropped to 1,14 million barrels per day on average, compared to that of 1,24 million barrels per day in 2002. This was due to the declining crude oil reserves and low investment in the crude oil sector.

The value of gas exports in the reporting year was $8.1 billion, higher than that of the previous year of $6.3 billion. Gas export value exceeded that of crude oil in the reporting period. The increase was due to, among others, the commencement of natural gas sales to Sembawang (Singapore) and Petronas (Malaysia). Viewed by price, in line with the high level of the world fuel oil price, the average price of liquefied natural gas (LNG) in 2003 was $4.79 per MMBTU, higher than the price in 2002 of $4.11 per MMBTU.

Imports

In the reporting year, imports grew at 9.4% so as to reach $39.0 billion. This was imports stemmed from the increase in oil/gas and non-oil/gas imports alike. The increase occurred in almost all product groups, in line with the increase in domestic demand (Table 6.6). Meanwhile, increased oil & gas imports were related to higher domestic consumption of fuel in line with growing economic activity

Table 6.5
Comparison of Major Non-Oil/Gas Exports

Indonesia	China	Vietnam	Thailand	Malaysia
Electrical Appliances	**Electrical Appliances**	**Textile**	**Machinery & Mechanic**	Thermionic Valves and Tubes, Photocells
Textile	Computer and Telecommunications	**Footwear**	**Electrical Appliances**	Electronic Integrated Circuits
Woods Products	**Machinery & Mechanic**	Rice	Computer and Parts	Parts and Accessories for Office Machines
Machinery & Mechanic	**Textile**	**Electrical Appliances**	Integrated Circuits & Parts	Telecommunications Equipment
Papers	Metal Products	**Woods Products**	**Chemical Products**	**Palm oils**
Copper	**Footwear**	Coffee	**Textile**	**Electrical Appliances**
Chemical Products	Transport Equipment	Rubber	Base Metal Products	Diodes and Transistors
Palm oils	Instructment and Apparatus	Cashew Nut, Shelled	Rubber	Television Receivers
Coal	Plastics Articles	Vegetable and Fruit	Transformers, Generator and Motors	Piezo Electric Crystals and Parts
Animal & Husb Product	Toys	**Coal**	Rice	Sound Recorders; Television Image
Footwear	Cotton Woven Fabrics	Articles Plastic	Vehicles Parts & Accessories (Others)	Radio Broadcast receivers

Table 6.6
Non-Oil/Gas Imports By Goods Category

Items	Value (Millions of $)		Growth (%)		Share (%)	
	2002	2003*	2002	2003*	2002	2003*
Consumer Goods	2,646	2,845	15.7	7.6	9.1	9.2
Raw Material Goods	20,847	22,264	-0.2	6.8	71.9	71.8
Capital Goods	5,497	5,913	-5.0	7.6	19.0	19.1

in the country as well as the increase of oil prices in the international market.

By category of non oil/gas imports, the import value of consumer goods up by 7.6%, in line with stronger economic growth stimulated by consumption activity. The increase in consumer goods imports included, among others, food & beverages for households, passenger cars, non-industrial transportation equipment, non-durable consumer goods, and military equipment (Table 6.7).

The increase in consumer goods imports did not include illegal imports of several agricultural commodities (such as rice and sugar) and textile and textile products that allegedly occurred in 2003. To prevent illegally imported products from entering as well as to protect domestic industry, government issued provisions for regulating import administration.[4] As stipulated in the provision, textile and textile product imports may only be conducted by producer importers (IP), and textile and textile product imports under certain HS codes shall be inspected prior to shipment.

4 Decree of the Minister of Trade and Industry No. 732/MPP/Kep/10/2002 Concerning Regulated Import of Textile and Decree No. 389/MPP/Kep/5/2003 Concerning Verification or Technical Retrieval of Textile and Textile Products Imports.

Table 6.8
Import of Raw Materials

Items	2002	2003*	2003*	
	Change (%)		Value (Millions of $)	Share (%)
Processed raw materials	-3.2	6.9	13,562	43.1
Primary raw materials	0.2	-0.7	2,576	8.3
Spare parts and accessories for transportation equipments	14.9	16.8	2,096	6.8
Spare parts and accessories for capital goods	-1.1	4.1	1,790	5.8
Food and beverages mainly for industry	22.8	4.5	1,227	4.0
Processed food and beverages	-7.4	35.6	984	3.2
Primary fuel and lubricants	-1.6	39.3	205	0.7
Proccessed fuel and lubricants	0.9	16.5	14	0.0
Total	**-0.2**	**6.8**	**22,264**	**71.8**

Raw material imports increased by 6.8% over the previous period (Table 6.8). The increase in raw material imports included imports of intermediate products of food & beverages, raw fuel and lubricants, intermediate fuel and lubricants, as well as spare-parts of transportation equipment. These raw material imports were used for satisfying the needs of production linked to both the consumption and domestic investment.

Table 6.7
Import of Consumption Goods

Items	2002	2003*	2003*	
	Change (%)		Value (Millions of $)	Share (%)
Non durable consumption goods	10.0	1.4	533	1.7
Household transportation vehicles	12.6	2.3	520	1.7
Food and beverages	16.8	2.0	391	1.3
Processed food and beverages	20.8	-10.0	384	1.2
Durable consumption goods	11.9	-3.2	351	1.1
Half durable consumption goods	24.5	4.6	281	0.9
Passanger cars	52.1	133.4	270	0.9
Military equipments	-8.4	110.4	115	0.4
Total	**15.7**	**7.6**	**2,845**	**9.2**

Table 6.9
Import of Capital Goods

Items	2002	2003*	2003*	
	Change (%)		Value (Millions of $)	Share (%)
Nuclear Reactor and Machinery	-10.4	-1.1	3.255	10.5
Generator & electronics	20.1	31.5	1.006	3.2
Locomotive, ship, & aircraft	-4.9	11.3	987	3.2
Optical & measurement devices	-10.2	-10.1	284	0.9
Passenger cars	38.5	156.4	270	0.9
Craftsmanship tools	2.2	13.5	46	0.1
Container & storage box	4.2	-27.6	45	0.1
Tractors & agriculture equipments	42.4	-36.8	20	0.1
Handicraft and accessories	-25.9	287.0	0	0.0
Total	**-5.0**	**7.6**	**5,913**	**19.1**

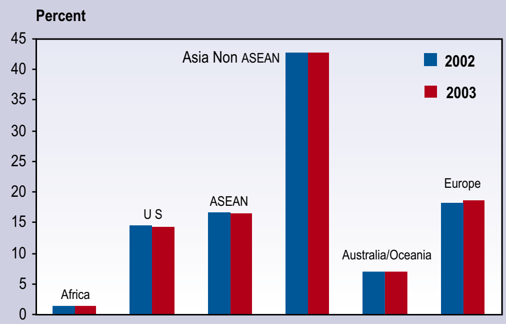


Chart 6.6
Share of Non-oil and Gas Imports by Country of Origin

Development of capital goods imports recorded an increase of 7.6%, or $5.9 billion (Table 6.9), which was used for supporting domestic investment activity. Viewed from the type of goods imported, the increase occurred in imports of generators and electronics, transportation equipment for production, locomotives, airplanes and ships, as well as hardware equipment.

By country of origin, non-oil/gas imports from Asian countries (other than ASEAN) contributed the largest share, followed by Europe, ASEAN, the Americas, Australia/ Oceania, and Africa (Chart 6.6). Compared to the previous year, the European share of goods imports increased, replacing the slightly declining share of goods imported from the Asian region and the Americas.

Services

With regard to the services account, deficit occurred in both non-oil/gas and oil/gas services. The widened non-oil/gas services deficit originated from, among others, the decrease in foreign exchange inflows from tourism, which only reached $4.0 billion, with 4.4 million visiting tourists, compared to $5.3 billion and 5 million tourists in the previous year. Various events from the Bali Tragedy in October 2002, Iraq war, and the J.W. Marriott bombing in early August 2003, had given a negative impact on tourism. In addition, along with the rising import activity, the freight charge for goods transportation of oil/gas and non-oil/ gas imports also experienced an increase in 2003.

Meanwhile, several non-oil/gas services recorded narrower deficit partly due to lower interest payments on foreign debt, lower transfer of private companies' profit, and a decrease in overseas payments for transportation services. On the other hand, foreign currency inflows from overseas Indonesian workers abroad increased by 4.8%, amounting to $1.3 billion.

CAPITAL ACCOUNT

In the reporting year, the net capital account recorded a deficit of $1.7 billion, wider than $1.1 billion in the previous year. The rise in the deficit stemmed from the deficit in the official capital account of $0.7 billion and that of the private capital account of $1.0 billion.

Official Capital Account

The official capital account consisted of government capital account and State-owned Enterprise (BUMN) capital account. On government capital account, the widened deficit was mainly due to increased debt payments by government in connection with the lower amount of government foreign debt rescheduled through the Paris Club and the London Club fora.

On the revenue side, the drawdown of the government foreign debt reached $2.0 billion, lower than in the previous period of $2.3 billion. Revenues from new foreign debt consisted of program loans and project loans. Program loan revenues amounted to $0.2 billion, lower than the $0.8 billion in the previous year in connection with several unfulfilled requirements in connection with such loans, such as completion of the Bill on Water Resources, the Bill on Investments, and the Bill on Financial Services Authority. Most of such program loans were received from The Japan Bank for International Cooperation (JBIC), while the others were in the form of Sector Program

Loans. Unlike the Program Loans, revenues from project loans in the reporting year amounted to $1.8 billion, up from $1.5 billion in the previous year. The majority of the project loans were received from the Consultative Group on Indonesia (CGI) forum, in the form of both Overseas Development Assistance/ODA and non-ODA. ODA loans received from both bilateral institutions and multilateral institutions amounted to $1.5 billion, an increase from $1.2 billion in the previous year. Meanwhile, non-ODA loan in the form of export credit facility amounted to $0.3 billion, increased by 21% from the previous year.

On the expenditure side, the matured government outstanding foreign debt reached $5.3 billion, lower than the $5.5 billion in 2002. Of that amount, realization of debt payment in the reporting period was only $2.6 billion due to the rescheduling of government debt. In 2003, rescheduled government debt reached $3.1 billion (comprising principal and interest), lower than $3.6 billion in 2002. (*Box: Government's External Debt Without IMF Program*)

Meanwhile, as to State-owned Enterprise Capital Account, the amount of State-owned Enterprise loan disbursement was $0.3 billion and loan payment was $0.7 billion, or a net deficit of $0.4 billion. This was below the net deficit in the previous year of $0.7 billion.

Against this background, outstanding government foreign debt reached $80.9 billion or 60.0% of total Indonesian foreign debt as of the end of 2003, an increase from $74.7 billion at the end of 2002 (Table 6.10). The increased government debt was partly a result of yen appreciation against the dollar. The impact of the yen appreciation was significant because the share of government foreign debt denominated in yen was 35.0% of total government foreign debt. Of the total government foreign debt, the debt from multilateral institutions still constituted the largest portion, followed by bilateral debt, export credit facility and other debts.

Viewed from creditor countries, Japan was the largest creditor, followed by the US. Meanwhile, as in the previous year, international institutions such as the IMF, IBRD, and ADB constituted the largest loan-providing institutions to the Indonesian government with a total amount of $28.3 billion.

Table 6.10
Indonesia's Outstanding Foreign Debt

(Millions of $)

Items	2001	2002	2003			
			Mar	Jun	Sep	Dec*
Government	**71.377**	**74.661**	**74.513**	**76.008**	**77.709**	**80.855**
Private	**60.058**	**55.212**	**53.750**	**53.287**	**52.991**	**52.203**
a. Financial institution	7.713	7.642	7.806	7.055	7.571	7.463
- Bank	6.649	4.870	4.850	4.059	4.414	4.300
- Non-bank	1.064	2.772	2.956	2.997	3.157	3.164
b. Non-financial institution	52.345	47.570	45.944	46.232	45.420	44.740
Securities	**1.638**	**1.470**	**1.203**	**1.290**	**1.253**	**1.794**
Total	**133.073**	**131.343**	**129.466**	**130.585**	**131.952**	**134.851**

Private Capital Account

The private capital account recorded a deficit of $1.1 billion, an increase from $0.8 billion in 2002. The widened deficit was mainly originated from the increase in private companies foreign debt payment. In general, this indicated an increasing capacity of the private sector to fulfill obligations to offshore creditors. This progress was caused by improvement in the rupiah exchange rate during the reporting year as well as the successful restructuring of several private companies that enhanced the certainty of foreign debt payments. The private capital account was grouped into the capital account of foreign investment companies, the short-term capital account in the form of portfolio investment, and other investments.

Foreign capital inflows (in the form of direct investment and loan) were estimated at $2.7 billion, a drop from $5.2 billion in 2002. The low realization of foreign direct investment was not in line with approval registered with BKPM (Investment Coordinating Board), which on the contrary, showed a 36% increase in the reporting year.

Capital inflows in the form of direct placements in FDI companies experienced a decline from $2.6 billion to $1.1 billion. The decline partly due to the low receipt from BUMN (State-owned Company) privatization through direct offering to strategic investors (strategic sales). This was because BUMN privatization in the reporting year was mainly carried out through Initial Public Offerings (IPOs) in the stock market. Viewed by the country of origin, the majority of foreign investment capital inflows were still from Japan and Singapore.

Meanwhile, capital inflows in the form of loans received by foreign companies from their overseas parent companies dropped from $2.6 billion in 2002 to $1.7 billion in 2003. The drop indicated a decline in fund demand through foreign debt disbursements along with relatively slow growth of investment.

On portfolio investment side, short-term capital inflows in the form of portfolio investment soared from a net amount of $1.2 billion in 2002 to a net amount of $2.3 billion in 2003. Portfolio investment consisted of securities issued domestically and abroad. Securities owned by residents, which were issued domestically and purchased by overseas parties amounted to $2.0 billion net, increasing from the previous period of $0.8 billion net. Meanwhile, securities owned by residents, which were issued abroad amounted to $0.2 billion, lower than $0.4 billion net in the previous year.

Securities issued domestically consisted of stocks and bonds whose net value was $1.1 billion and $0.9 billion, an increase from the previous period of $0.9 billion and a deficit of $0.03 billion respectively. Increasing capital inflows from stock transactions mainly took place on the eve of domestic stock purchases by overseas investors since June 2003, simultaneously with the commencement of the BUMN privatization program through the stock market in the form of Initial Public Offerings (IPOs). As a result of intensive foreign transactions in the market, the value and volume of transactions in stock markets sharply increased so as to drive IHSG (Jakarta Composite Index) up, especially in the second half of 2003 (Chart 6.7).

In line with the rising share index, portfolio investment in the form of bonds, especially of corporate bonds and government bonds, showed a positive development. Capital inflows in the reporting year derived from corporate bonds recorded a surplus of $0.3 billion, after suffering a deficit of $0.2 billion in the previous year. The government bonds were also up, in which purchase of government bonds by overseas parties increased from $0.1 billion to $0.6 billion. Meanwhile, capital inflows from the purchase of SBI by overseas parties decreased by $0.05 billion.

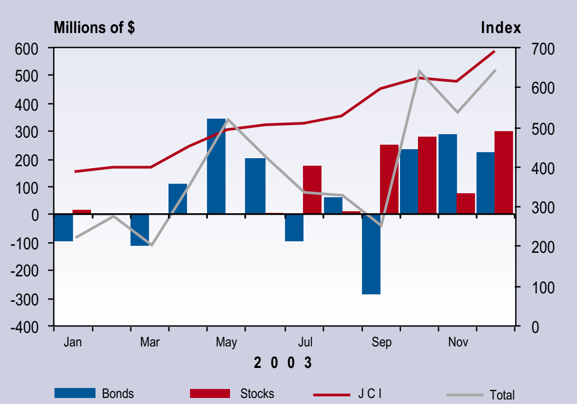


Chart 6.7
Foreign Portfolio Investments

Other investment during the reporting year was in deficit of $2.4 billion, slightly wider than the previous year deficit of $2.3 billion. The capital account item of other investments consisted of foreign loans obtained by non-FDI private companies and others (among others in the form of companies' additional capital and the yield of the bank restructuring program), which recorded a deficit of $3.5 billion and a surplus of $1.1 billion respectively, an increase from a deficit of $3.0 billion and a surplus of $0.8 billion respectively in the previous year. The widened deficit of non-FDI companies' foreign debt resulted from an increase in foreign debt payments that was higher than the increase in drawdown of foreign debt by non-FDI companies (banks and non-banks). Payment of bank and non-bank foreign debt was $4.2 and $5.3 billion respectively, higher than $3.6 and $2.7 billion respectively in 2002. This included in foreign debt restructuring, among other rescheduled foreign debt. Meanwhile, disbursement of foreign debt by banks and non-banks amounted to $4.1 and $1.9 billion, an increase from $2.4 and $0.8 billion respectively in 2002.

In order to improve their financial structure, several private companies have successfully restructured their debts. Settlement of private foreign debt rescheduling through the Jakarta Initiative Task Force/JITF) amounted to a cumulative value of $20.5 billion, or about 70.0% of the total foreign debt mediated by JITF.[5] In the banking sector, the foreign debt rescheduling process conducted through the program of Exchange Offer I and II (EO I and EO II) also showed a positive settlement. Outstanding principal payment under EO II by October 2003 was recorded at $1.4 billion ($0.3 billion for the Frozen Banks (BBO/BBKU) category, and $1.1 billion for operating banks). Under the EO II, payment of principal and interest in June 2003 amounted to $1.0 billion and interest payment amounted to $25.7 million in December 2003. Also during 2003, a prepayment transaction under EO II by obligors amounting to $83.2

Table 6.11
Foreign Debts by Maturity

(Millions of $)

NO	Maturity	December 2003 *)					
		Govern-ment	Private				Total
			Financial Institution		Non-financial Institution[3]	Total Private	
			Bank	Non-bank			
1	Short-term [1]	97	491	141	1,715	2,347	2,444
2	Medium & Long term [2]	80,758	3,808	3,023	44,818	51,649	132,407
	Total	**80,855**	**4,300**	**3,164**	**46,533**	**53,997**	**134,851**

1) Up to one year
2) More than one year
3) Including securities held by non-residents

5 Report of JITF, as of October 2003

Table 6.12
Foreign Debt Indicators

(Percent)

Indicator	1997	1998	1999	2000	2001	2002r	2003*	World Bank Criteria
DSR	44,5	57,9	56,8	41,1	41,4	33,1	33,8	20
Outstanding debt/ Exports	207,3	261,8	252,1	191,0	200,7	193,9	191,1	130 - 220
Outstanding debt/ GDP	62,2	146,3	105,0	93,8	91,1	76,0	64,0	50 - 80

*) Provisional figure based on outstanding of December 2003 and BOPs as of January 29, 2004

million and buyback transactions by some obligors under EO II totaling $104.7 million.

Against this background, private foreign debt transactions, private foreign debt by the end of the reporting year stood at $53.9 billion (including securities), down 4.7% down compared to the previous year. Out of the total debt, the largest portion contributed by non-financial companies, followed by financial companies (banks and non-banks).

Overall, after calculating the total transactions of government and private debt, the Indonesia's total foreign debt amounted to $134.8 billion by the end of 2003, an increase compared to that at the end of 2002, which was $131.3 billion. Manufacturing was the largest sector financed by foreign debt, amounting to $26.4 billion or 20.0% of the total foreign debt. The second largest was the financial sector, followed by the leasing and company service sector. Based on the composition of foreign exchange, foreign debt denominated in US dollar was still the largest amounting to $78.1 billion or 57.9%, followed by yen denominated debt with 23.6%. By maturity, short-term debt constituted only about 1.8% of the total Indonesian foreign debt, while the remaining was medium and long-term debt. The vast majority of short-term debt (95.8%) belonged to private companies (Table 6.11).

Various efforts have been successfully made to reduce the foreign debt, This was observable from various improvements of debt indicators. Compared to GDP and total exports, the amount of foreign debt showed a decreasing ratio, namely, from 76.0% and 193.9% to 64.0% and 191.1% respectively (Table 6.12). However, the debt payment ratio to export capacity (DSR) in 2003 increased to 33.8% from 33.1% in 2002. This indicated that although Indonesia's foreign debt amount was declining, the portion of foreign exchange from export to be used for foreign debt payment remained large.

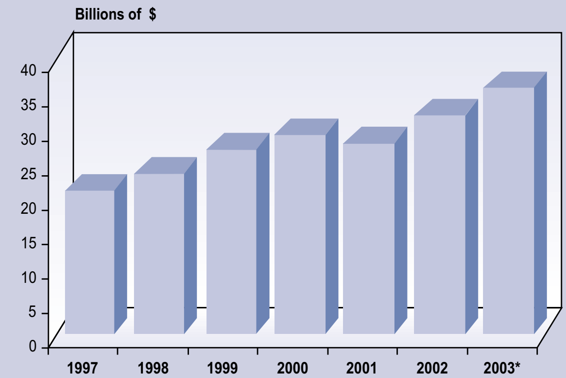


Chart 6.8
International Reserves

International Reserves

With a relatively large balance of payment surplus, Indonesia's official reserves at the end of the reporting period reached $36.2 billion [6] or equivalent to 7.1 months worth of imports plus official foreign debt repayment (Chart 6.8). The increase in official reserves was mainly driven by the rise of oil prices in the international market and financing from the IMF.

6 Foreign assets in the form of official international reserves do not include private foreign assets. Private foreign assets are derived from all accounts both current and capital account by private sector, which is estimated to be around $12 billions at the end of 2003

Box Government's External Debt Without IMF Program

In November 1997, the Government of Indonesia entered into a financial aid agreement with the IMF to strengthen foreign exchange reserves, to support balance of payment performance, to restore market confidence, and to help stabilize the rupiah exchange rate. The IMF aid package was initially extended in the form of a Stand-by Arrangement (SBA) and, later, in the form of an Extended Fund Facility (EFF) in August 1998. In view of the prolonged nature of the crisis, the financial aid was renewed as a new Extended Fund Facility in February 2000.

At the end of 2003, IMF loan commitments of $16.0 billion had been fully disbursed by the Government of Indonesia. Of total disbursements, $6.0 billion had been repaid, leaving an outstanding amount of $10.0 billion at end-2003. With an end to the IMF program and all commitments fully disbursed, pursuant to the agreed schedule of repayment, the IMF loan would be settled at the end of 2010, unless the government pre-pays its debt.

On another aspect of external debt, the end of the IMF program also ended the government's opportunity to reschedule its outstanding bilateral external debt through the Paris Club (PC) forum.

Through the PC agreements, which have been conducted three times, the Government of Indonesia has rescheduled some $15 billion of its outstanding external debt during the period from September 1998 to December 2003 with new maturities ranging from 12 to 20 years and grace periods from 3 to 10 years.

The PC forum also reached agreements on debt conversion/swaps of the Indonesian Government's external debt. Agreement on a debt swap program was reached during PC II; it applied to 100% of ODA debt and 10% of non-ODA debt, or up to SDR 10 million. In PC III, this debt swap program was increased to 100% of ODA debt and 20% of non-ODA debt, or up to SDR 30 million.

By the end of 2003, the debt swap program had been implemented with the Government of Germany in the amount of DEM50 million for a primary education project. On November 5, 2003 the government of Germany agreed to continue with a second stage debt swap program in the amount of ± EUR11.5 million for another secondary education project. In June 2003, an agreement was also reached on a debt swap in the form of Memorandum of Understanding with France in the amount of $65 million. A number of other creditor countries such as Italy, Sweden, and Norway have also shown interest in granting debt swap facilities to the Indonesian Government. However, the relief granted through this sort of program is still relatively tiny. It is believed that this sort of program will provide some value-added for social and economics issues, but it does not represent a significant reduction in Indonesia's external debt.

In addition to rescheduling official external debt through the PC, the government rescheduled commercial external debt through the forum of London Club (LC). This is a consequence of the Comparability of Treatment principle as required in the PC agreements.

Without the PC, beginning in 2004 the government will have to increase its average external debt repayment by some $2.5 to $3 per year relative in the period 1998 to 2003.

Another consequence of the government's end to the IMF program is the growing difficulty in securing foreign financing and disbursements from official creditors. That is because during the period under the IMF program, those creditors took the IMF as their main reference point in evaluating implementation of the economic stabilization program as agreed in the Letter of Intents (LoI). The Indonesian government's commitment to comply with contractual obligations is usually taken by the creditors as one of the prerequisites for disbursements of government loans as formulated in a policy matrix.

Statistics on government external debt disbursements during the last six years show a declining tendency, with average disbursement of some 56% of loan commitments. This relatively low percentage was generally caused by the long period of time needed for the government to implement policies as required by the creditors. In particular, some aspects of the policy matrix concern laws (e.g., laws on electricity and investment), which must be approved by the parliament. Other factors that further delay debt disbursements are weak project management and differences in fiscal years from the creditor countries.

The requirements for debt disbursements as laid out in policy matrices always refer to Letter of Intents (LoI). With the end of the IMF program, the government has prepared a comprehensive macroeconomic stabilization program, which was expressed in the white paper (see Box : The White Paper) It is one aspect of transparency, commitment and accountability in Indonesia's post-IMF development program.

As such, the white paper will be taken as a reference for creditors and investors to assess the

Table 1
Paris Club

No.	Description	Paris Club I	Paris Club II	Paris Club III
1.	Date of Signature	September 25,1998	April 13, 2000	April 12, 2002
2.	Consolidation Period	Aug '98 - March '00	Apr '00 - Maret'02	Apr '02 - Des '03
3.	Amount to be rescheduled	$4,5 Billion	5,8 Billion	$5,4 Billion
4.	**ODA**			
	Maturity	20 years	20 years	20 years
	Gross Period	5 years	7 years	10 years
	Non ODA			
	Maturity	12 years	15 years	18 years
	Gross Period	3 years	3 years	5 years
5.	Cut off date	July 1, 1997	July 1, 1997	July 1, 1997
6.	Minimum Amount	SDR 1 Million	SDR 1 Juta	SDR 1 Million
7.	Debt swap	None	100% ODA and 10% non ODA or up to SDR 10 Million	100% ODA and 20% non ODA or up to SDR 30 Million

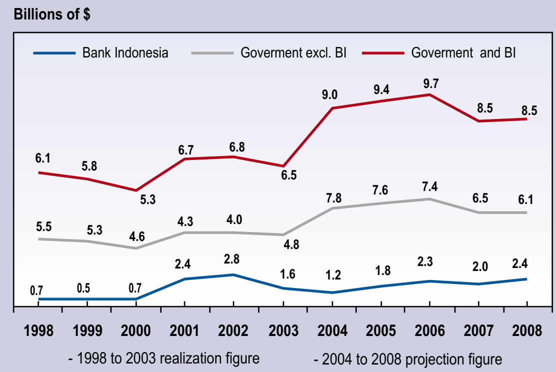
Source : IIE Web Site Bank Indonesia

Table 2
London Club

No.	Description	London Club I	London Club II	London Club III *)
1	Date of Signature	March 29, 99	Sep 28, 00	Sep 6, 02
2	Maturity (year)	10.5	12.5	17.5
	Gross Period (year)	3	3	6.5
3	Amount to be rescheduled	**$210 million**	**$340 million**	**$1.3 Billion**

Source: Bank Indonesia
***)** The maturity date of the principal of the 1996 & 1997 syndicated loan was extended as follows:
Syndicared loan 1996 matured 21.05.04 to 21.03.05
Syndicared loan 1997 matured 25.03.05 to 25.01.06

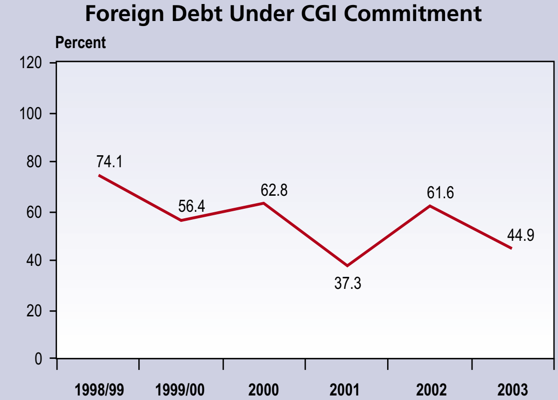
Chart 1.
Foreign Debt Repayment



credibility of the government in carrying out its development and reform programs. The credibility of the white paper in the eyes of investors and creditors will depend heavily upon the government's commitment to fulfilling the white paper.

Consequently, it is very likely that the decision to extend loans using the formulation of a policy matrix as the pre-requisite for disbursement future will refer to the white paper as the main reference point for creditors. Eventually, opportunities to obtain foreign financing (or to disburse loan commitments) from official creditors will depend on the government's credibility and commitments as elaborated in the white paper.

Chart 2.
Percentage of Actual Disbursement of Government Foreign Debt Under CGI Commitment



Chapter 7:
Government Finance

Chapter 7: Government Finance

In 2003 the government's fiscal policy was aimed at balancing between fiscal stimulus and sustainability concerns. The improvement in the monetary condition including lower interest rates and the appreciation of the rupiah supported achieving the deficit reduction target. Due to the difficult issues around deficit financing in 2004, fiscal policy will continue to target lower deficits and sound debt management.

Maintaining economic recovery momentum post-Bali-bombing required the government to institute more expansive fiscal policies than the previous years. However, expansion runs into two major challenges. The first is the growing payment for the principal and debt interest and second the need to maintain fiscal sustainability. A number of other challenges arose including lower oil production and delayed policy implementation. Amidst these challenges, fiscal policy was supported by improving monetary conditions which reduced the level of debt payments and allowed more opportunities for fiscal flexibility (Table 7.1).

Under these circumstances the preliminary realization of 2003 APBN (State Budget) shows a budget deficit of Rp33.7 trillion (1.9% of GDP), an increase from the realized 1.5% of GDP achieved in 2002. This increase in the deficit occurred despite fiscal consolidation measures including higher tax revenues, expenditure reductions (especially subsidy) and gradual reduction in government debt. Against this development, the government fiscal operations in 2003 recorded a surplus primary balance and declined debt ratio to GDP thus supporting the achievement of fiscal sustainability (Table 7.2).[1] These achievements have led to increase confidence in macro economic stability.

Table 7.1
State Budget Assumptions

Assumption	2002	2003		
	Audited Budget	Budget	Revised Budget [1]	Realization Temporary [2]
Annual economic growth (%)	3.7	4	4	4.1
Inflation (%)	10.03	9	6	5.06
Average exchange rate (Rp/$)	9.311	9.000	8.500	8.577
Average 3 months SBI rates (%)	15.2	13	10.1	10.2
International oil price ($/barrel)	24.1	22	27.9	28.75
Indonesia oil production (million of barrels/day)	1.26	1.27	1.09	1.09

1 Up to September 2003
2 Preliminary realization per January 2004 (Minister of Finance Press Release January 9, 2004)

GOVERNMENT REVENUES AND GRANTS

After declining for two years, the ratio of state revenue and grants to GDP 2003 rose to 19.4%, above the budget target set (Table 7.2). This increase was in line with the increase in tax to GDP ratio. Meanwhile, the ratio of non-tax revenues to GDP, particularly oil and gas, relatively unchanged (Chart 7.1).[2]

The tax to GDP ratio rose from 13.0% in 2002 to 13.8% in 2003. This increase was related to policies in the

1 Fiscal sustainability refers to the concept of, *Fiscal Solvency and Sustainability in Economic Management*, World Bank 1999, introduced by Hinh T Dinh. This concept measures the soundness of future fiscal condition associated with domestic and foreign debt burden as well as recent macro economic conditions. Sustainability concept refers to government's ability to repay or lower its outstanding debt, reflected in the primary balance as shown by a lower surplus and lower debt to GDP ratio.

Table 7.2
Development of Government Financial Operation

(Trillions of Rp)

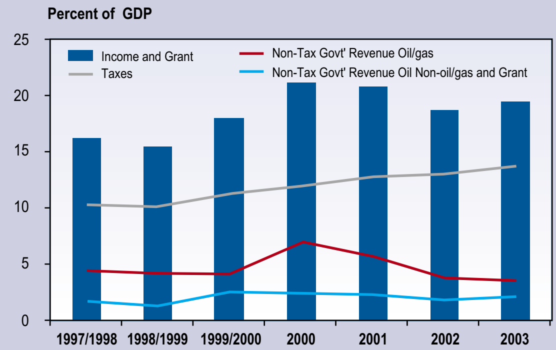
Items	2002 Audited State Budget Nominal	2002 Audited State Budget % GDP	2003 State Budget Nominal	2003 State Budget % GDP	2003 Revised State Budget [1] Nominal	2003 Revised State Budget [1] % GDP	2003 Realization Temporary [2] Nominal	2003 Realization Temporary [2] % GDP
A. Government Revenues and Grants	**298.6**	**18.5**	**336.2**	**17.3**	**342.8**	**19.1**	**341.1**	**19.4**
I. Domestic Revenues	**298.5**	**18.5**	**336.2**	**17.3**	**342.4**	**19.1**	**340.7**	**19.4**
1. Tax Revenues	**210.1**	**13.0**	**254.1**	**13.1**	**248.4**	**13.9**	**241.6**	**13.8**
2. Government Revenues Non-taxes	**88.4**	**5.5**	**82.0**	**4.2**	**94.0**	**5.2**	**99.0**	**5.6**
a. Oil	47.7	3.0	39.9	2.1	41.7	2.3	42.6	2.4
b. Gas	12.3	0.8	16.3	0.8	18.7	1.0	19.0	1.1
II. Grants	**0.1**	**0.0**	**-**	**-**	**0.3**	**0.0**	**0.4**	**0.0**
B. Government Expenditures	**322.2**	**20.0**	**370.6**	**19.1**	**377.2**	**21.0**	**374.8**	**21.3**
I. Central Government Expenditures	**224.0**	**13.9**	**253.7**	**13.1**	**257.9**	**14.4**	**254.1**	**14.5**
1. Routine Expenditures	**186.6**	**11.6**	**188.6**	**9.7**	**191.8**	**10.7**	**189.1**	**10.8**
a. Personnel expenditures	39.5	2.5	50.2	2.6	50.4	2.8	47.3	2.7
b. Material expenditures	12.8	0.8	15.4	0.8	16.2	0.9	13.9	0.8
c. Interest payment	87.7	5.4	82.0	4.2	72.2	4.0	69.2	3.9
d. Subsidies	43.6	2.7	25.5	1.3	34.7	1.9	43.9	2.5
e. Other routine expenditures	3.1	0.2	15.5	0.8	18.3	1.0	14.8	0.8
2. Development expenditures	**37.3**	**2.3**	**65.1**	**3.4**	**66.1**	**3.7**	**65.0**	**3.7**
II. Regional expenditures	**98.2**	**6.1**	**116.9**	**6.0**	**119.3**	**6.7**	**120.7**	**6.9**
C. Primary Balance	**64.1**	**4.0**	**47.5**	**2.5**	**37.8**	**2.1**	**35.5**	**2.0**
D. Budget Surplus (Deficit)	**-23.6**	**-1.5**	**-34.4**	**-1.8**	**-34.4**	**-1.9**	**-33.7**	**-1.9**
Statistical Discrepancy	0.0		-0.0		-0.0		0.0	
E. Financing	**23.6**	**1.5**	**34.4**	**1.8**	**34.4**	**1.9**	**33.7**	**1.9**
I. Domestic Financing	**16.9**	**1.1**	**22.5**	**1.2**	**31.5**	**1.8**	**32.1**	**1.8**
1. Domestic banks financing	**-8.2**	**-0.5**	**8.5**	**0.4**	**8.5**	**0.5**	**8.3**	**0.5**
2. Non-domestic banks financing	**25.2**	**1.6**	**14.0**	**0.7**	**23.0**	**1.3**	**23.9**	**1.4**
a. Privatization proceed	7.7	0.5	8.0	0.4	6.4	0.4	7.3	0.4
b. Recovery of bank asset	19.4	1.2	18.0	0.9	19.6	1.1	19.7	1.1
c. Government bonds (Net)	-1.9	-0.1	-12.1	-0.6	-3.0	-0.2	-3.1	-0.2
- Issuance	2.0	0.1	7.7	0.4	11.7	0.7	11.3	0.6
- Due	-3.9	-0.2	-6.2	-0.3	-6.2	-0.3	-6.2	-0.4
- Buyback	-	-	-13.6	-0.7	-8.5	-0.5	-8.3	-0.5
II. Foreign Financing (Net)	**6.6**	**0.4**	**12.0**	**0.6**	**2.9**	**0.2**	**1.6**	**0.1**
1. Gross drawing	**18.9**	**1.2**	**29.3**	**1.5**	**20.5**	**1.1**	**17.7**	**1.0**
a. Program aid	7.2	0.4	10.4	0.5	5.7	0.3	1.8	0.1
b. Project aid	11.7	0.7	18.9	1.0	14.8	0.8	15.9	0.9
2. Amortization	**-12.3**	**-0.8**	**-17.3**	**-0.9**	**-17.6**	**-1.0**	**-16.1**	**-0.9**
Memorandum Item:								
Total Government Debt to GDP Ratio [3]		77.0						68.0

Notes:
1 Up to September 2003
2 Preliminary realization per January 2004 (Minister of Finance Press Release January 9, 2004)
3 Including Government Securities and Bonds, Excluding IMF Loans
Source: Ministry of Finance (processed)

tax sector including: (a) intensification and extensification of tax revenue, (b) improved monitoring, arrears collection and law enforcement, (c) tax deregulation, modernization of tax and excise administrative systems, (d) excise service system application, (e) elimination of plain cigarettes and fake tape circulation, and (f) reduced smuggling.

2 Detail information pertaining to government expenditures is available on Appendix F, Table 31

Compared to 2002, tax revenue nominally increased approximately 15% thus became the main contributor with 71% of total state revenue (Chart 7.2). In line with faster growth, several tax components such as non oil and gas income taxes (PPh), value added taxes (PPN), and land and property taxes (PBB) increased significantly. Despite these nominal increases over 2002, taxes were still below target due to, among other things: (a) a tax incentives policy

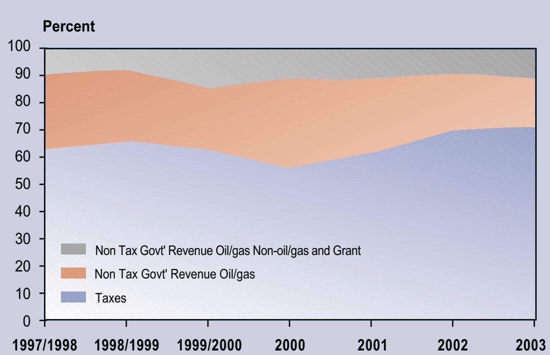


Notes :
1997/1998 to 2000 : Fiscal Year; 2001 to 2003 : Calendar Year
1997/1998 to 2002 : Realized State Budget; 2003: temporary realization per January 4, 2004
Source : Ministry of Finance (processed)

Chart 7.1.
Composition of Government Revenue to GDP

package for economic stimulus, (b) delayed on policy implementation with respect to PPh, PPN and PBB, (c) changed macro economic assumptions including inflation, the interest rate and the exchange rate, and (d) lower than predicted cigarette sales. The tax incentives policy package included the postponement of VAT imposition on six strategic commodities, the revocation of luxury taxes on 23 types of goods (PPn BM), the reduction of luxury taxes on nine types of goods, and no imposition of VAT on capital goods classified as strategic.

In 2003, the ratio of non-tax revenues to GDP remained 5.6%. In oil and gas, sharp increases in international prices did not increase the ratio as domestic oil production fell. While the non-oil/gas non-tax revenue ratio to GDP has not changed significantly, although a series of policy steps have been taken. These steps include: (a) optimizing and intensifying the collection of tax arrears in the forestry, general mining and fishery sectors, (b) improved performance and stability in state enterprises through the enforcement of good corporate governance, and (c) the evaluation and fixing of non-tax revenue fees in various ministries. Despite the lack of increase in the ratio of non-tax revenues to GDP, there was a nominal increase in non-tax revenues over 2002 mainly from the profits of state-owned enterprises in response to higher payout ratio and other non-tax revenues.



Notes :
1997/1998 to 2000 : Fiscal Year; 2001 to 2003 : Calendar Year
1997/1998 to 2002 : Realized State Budget; 2003: temporary realization per January 4, 2004;
2004 : State Budget
Source : Ministry of Finance (processed)

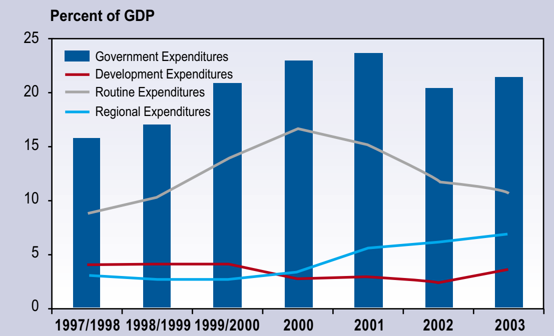
Chart 7.2.
Composition of Government Revenues to Total Government Revenue

GOVERNMENT EXPENDITURES

The government expenditure ratio to GDP which dropped in 2002 increased in 2003 to 21.3%, above the budget target (Table 7.2). The increase occurred in higher percentage development spending to GDP as part of fiscal stimulus and higher percentage of regional transfers, partly in response to higher world oil price. Meanwhile, the ratio of routine expenditure to GDP decreased, thus allowing room to raise development spending (Chart 7.3). In 2003, the allocation for regional and development spending respectively increased to 32.2% and 17.3% from the total budget, while routine expenditure fell to 50.5% from the total budget (Chart 7.4).[3]

The fall in the routine budget allocation was affected by the lower cost of debt interest with no change on subsidy costs. Positive developments in monetary indicators (lower interest rates on SBI and the appreciation of the rupiah) and reductions in government bonds outstanding actually reduced debt interest payments.

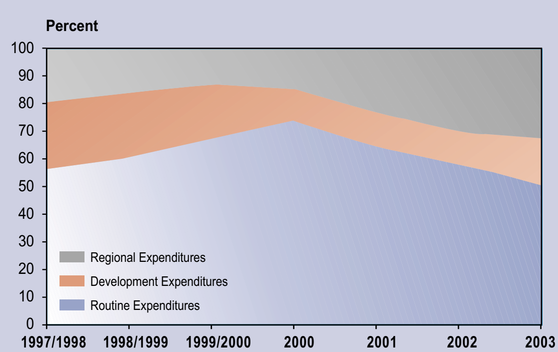
3 Detail information pertaining to government expenditures is available on Appendix F, Table 31



Notes :
1997/1998 to 2000 : Fiscal Year; 2001 to 2003 : Calendar Year
1997/1998 to 2002 : Realized State Budget; 2003: temporary realization per January 4, 2004;
2004 : State Budget
Source : Ministry of Finance (processed)

Chart 7.3.
Composition of Government Expenditure to GDP

Realized fuel subsidies fell compared to in 2002, but increased substantially compared to budgeted levels. In 2003, the government did not drastically raise the domestic oil fuel though international oil prices increased sharply to $28.8 per barrel. This decision was taken due to the impracticality of fully passing international prices through to domestic fuel prices adjusted to market prices. This resulted in an increase in subsidies compared to the budget target, meaning that the government did not enjoy increased profits from oil and gas prices (windfall profits). On the other hand static fuel prices helped lowering inflation in 2003.



Notes :
1997/1998 to 2000 : Fiscal Year; 2001 to 2003 : Calendar Year
1997/1998 to 2002 : Realized State Budget; 2003: temporary realization per January 4, 2004;
2004 : State Budget
Source : Ministry of Finance (processed)

Chart 7.4
Government Expenditures by Composition

DEFICIT FINANCING

With government expenditures higher than government revenues, the government had to make more effort to seek deficit financing in 2003. This was driven by the need to pay off government bonds coming due, foreign principal loan payments and the government decision to reduce the domestic debt position through government bond buybacks.

As in the previous year, the main source of deficit financing was still from the IBRA's assets selling program with the amount relatively equivalent to in 2002, namely about Rp19 trillion.[4] Revenues generated from the privatization of State Owned Enterprises (BUMN) were relatively unchanged from 2002, at approximately Rp.7 trillion.[5] However, foreign loans disbursed fell from the equivalent of Rp18.9 trillion in 2002 to the equivalent of Rp17.7 trillion in 2003 as program loans fell (Table 7.2).[6] Lower program loan disbursements were affected by the shortfall on implementing of several policy matrix (requirements for the loans), especially relating to the completion of bills in Parliament, among others a Bill on Water Resources, Investment, and the Financial Service Authority. This condition was exacerbated by the increase in principal payments in 2003. Thus, the net inflow of official foreign debt in 2003 was lower than the previous year.

To meet deficit financing needs the government increased domestic bond issuance and delayed government bond buybacks.[7] Several strategies were adopted by the government to increase the absorption potential of the market and to reduce the maturity of obligations including

4 This payment from IBRA is higher than its initial target of Rp18 trillion, mainly due to changes in IBRA's payment composition from bond to cash. In achieving the fiscal target, IBRA's programs include the sales of asset such as loans, properties, strategic, investment, and securities as well as Bank Danamon's divestment. In addition to cash payments, IBRA submit the proceeds of asset bond swap and cash bond swap in the form of bonds around Rp6 trillion.

5 Proceeds from this privatization is slightly lower than its target of Rp8 trillion, mainly attributable to ill-prepared sales of several state-owned enterprises, which have been targeted to be sold in 2003. Proceeds in 2003 came from IPO of Bank Rakyat Indonesia, Bank Mandiri and Perusahaan Gas Negara, as well as partial divestment of PT Indocement

6 Preliminary foreign loan disbursement largely consist of project aid from CGI of $1.8 billion and program aid from JBIC of $0.2 billion

7 Other than stated in the state budget (APBN), the asset bond swap and cash bond swap from IBRA around Rp6 trillion implies less outstanding government bonds.

direct approaches to less active yet potential buyer, such as pension funds and insurance companies. However, such efforts were not capable of meeting all deficit financing needs, hence prompting the government withdrew savings amounting to Rp8.3 trillion.

IMPACT OF GOVERNMENT FINANCIAL OPERATION ON REAL SECTOR

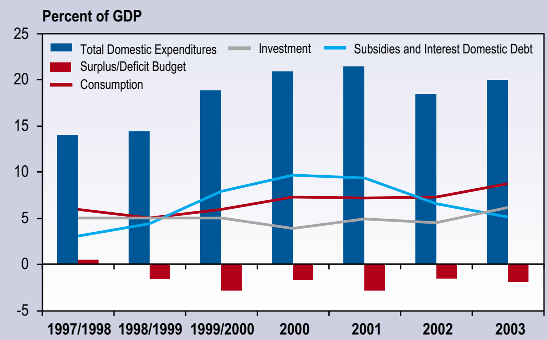
The government fiscal deficit impact on the real sector increased from 4.6% of GDP in 2002 to 5.1% of GDP in 2003. On the expenditure side, the increase was mainly due to rise in the ratio of government consumption to GDP, followed by a rise in the government investment ratio to GDP, while the transfer payment ratio to GDP fell. The government consumption ratio increased due to salary increases for civil servants, an increase in the general allocation funds (DAU) in line with the hike in international oil prices and increases in other routine expenses especially the preparation for the 2004 General Election. The government investment ratio to GDP increased in all

Table 7.3.
Impact of Government Financial Operations on the Real Sector

(Trillions of Rp)

Items	2002		2003	
	Nominal	% GDP	Nominal	% GDP
I. Revenues	**221.0**	**13.7**	**260.3**	**14.8**
Tax (excl. income tax oil and gas)	192.6	12.0	222.8	12.7
Domestic Revenues Non-taxes (excl. oil and gas)	28.4	1.8	37.5	2.1
II. Expenditures (G = C+I+Tr)	**295.5**	**18.4**	**350.4**	**19.9**
A. Government Consumption - C	117.4	7.3	152.8	8.7
Domestic Personnel Expenditures	38.5	2.4	46.4	2.6
Domestic Expenditures	12.5	0.8	13.2	0.8
General Allocation Funds & Sharing Allocation Funds	59.8	3.7	69.1	3.9
Special Autonomy Funds and Balancing	3.5	0.2	9.3	0.5
Other Routine Expenditures	3.1	0.2	14.8	0.8
B. Government Investment - (I)	72.2	4.5	107.3	6.1
Rupiah Financing	25.6	1.6	48.8	2.8
Project Aid	11.7	0.7	16.2	0.9
General Allocation Funds & Sharing Allocation Funds	34.3	2.1	39.6	2.3
Special Allocation Funds	0.6	0.0	2.7	0.2
C. Transfer Payment (Tr)	105.9	6.6	90.2	5.1
Domestic Interest Payments	62.3	3.9	46.4	2.6
Subsidies	43.6	2.7	43.9	2.5
III. Surplus / Deficit	**-74.5**	**-4.6**	**-90.0**	**-5.1**

Notes:
2002: Realized State Budget.
2003: Preliminary realization per January 2004 (Ministry of Finance Press Release, January 9, 2004), Using Assumed Proportion for DAU and DBH.
Sources : Ministry of Finance (processed)



Notes :
2002: State Budget-Calculation
2003: Temporary realization per January 4, 2004 (Ministry of Finance Press Release, Januari 9, 2004)
Source : Ministry of Finance (processed)

Chart 7.5.
Composition of Domestic Government Expenditure to GDP

components. Funding in rupiah and project expenditure rose as part of the fiscal stimulus this year while increases in profit sharing funds to the regions rose in line with oil prices. Meanwhile, ratio of transfer payments (over GDP) fell in all of its components, particularly domestic debt interest as monetary conditions improved (Table 7.3). Overall, there was a growth of government investment in 2003. In 2000 – 2002, the government investment ratio to GDP fell due to increased transfer payments. However in 2003 this trend reversed, the investment share in GDP returned to the level of 1997/1998 (approximately 5% of GDP) (Chart 7.5).

The fiscal impulse *(Box: Using the Fiscal Impulse to Calculate the Stance of Fiscal Policy)*, policy in 2003 was more neutral than previous years.[8] The fiscal expansion in 2003 was derived from changes in potential GDP or economic urgency. Neutral fiscal policy does not provide any significant impetus to aggregate demand.

RUPIAH AND FOREIGN CURRENCY IMPACT OF GOVERNMENT FISCAL OPERATIONS

Along with the increased budget deficit, government fiscal operations are estimated to have

8 Test on fiscal policy stance was based on fiscal impulse concept, introduced by Peter S. Heller, et. all (IMF Occasional Paper No. 44, 1986)

Table 7.4.
Rupiah Impact of State Budget 2002-2003

(Trillions of Rp)

Items	2002	2003
A. Rupiah revenues		
Tax (excl. income tax oil and gas)	192.6	222.8
Oil and Gas (oil and gas non-tax govt'revenues and income tax)	19.7	14.0
Oil and Gas non-tax govt'revenues	28.4	37.5
Privatization proceeds	2.2	7.3
Recovery of bank asset	11.9	19.7
Government bonds	-1.9	-3.1
Total revenues	**253.0**	**298.2**
B. Rupiah expenditures		
Operational	160.0	164.7
Domestic Personnel	38.5	46.4
Subsidies	43.6	43.9
Domestic Interest payments	62.3	46.4
Other routine expenditures	15.7	28.0
Investment	28.0	52.1
Balance budget	98.2	120.7
Total expenditures	**286.2**	**337.4**
C. Statistical Discrepancy	0.0	0.0
D. Rupiah impact (- =expantions; +=contractions)	**-33.2**	**-39.2**

Notes:
2002: Realized State Budget.
2003: Preliminary realization per January 2004 (Ministry of Finance Press Release, January 9, 2004), Using Assumed Proportion for Oil/Gas Revenues and Project Spending
Sources : Ministry of Finance (proceseed)

Table 7.5.
Foreign Exchange Impact of State Budget 2002-2003

(Trillions of Rp)

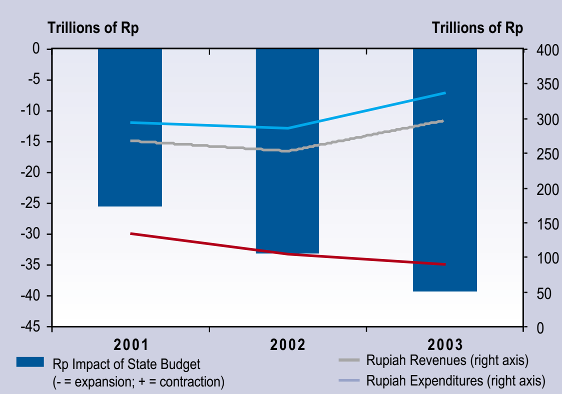
Items	2002	2003
A. Current Account	**21.8**	**29.4**
Oil and Gas Revenues (oil and gas non-tax govt'revenues and income tax)	57.7	66.3
Project Aid Import	-9.4	-12.9
Foreign interest Payments	-25.4	-22.9
Overseas Personnel Expenditures	-1.0	-0.9
External Material Expenditures	-0.2	-0.7
Grants	0.1	0.4
B. Net Official Capital Inflows	**19.6**	**1.6**
Foreign Financing (Net)	6.6	1.6
Privatization proceeds	5.5	0.0
Recovery of bank asset	7.5	0.0
C. Foreign Exchange Impact (A+B) (-=outflow; +=inflow)	**41.4**	**30.9**

Notes:
2002: Realized State Budget.
2003: Preliminary realization per January 2004 (Ministry of Finance Press Release, January 9, 2004), Using Assumed Proportion for Oil/Gas Revenues and Project Spendings.
Sources : Ministry of Finance (proceseed)

contributed more to the net expansion of rupiah than in the previous year, at Rp39 trillion (Table 7.4). This net expansion of rupiah was chiefly driven by the increase in development costs and regional budgets. Meanwhile, transfer payment including subsidies and debt interest payments fell (Chart 7.6).

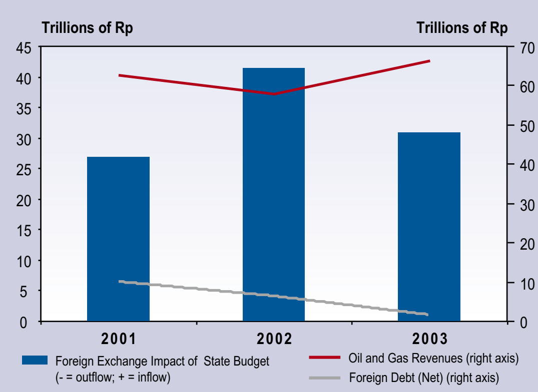
Government fiscal operations on foreign currency are estimated to have resulted in lower net income than that of 2002, decreasing to Rp.30.9 trillion due to lower net foreign debt, as well as the absence of privatizations and IBRA revenues in foreign currency (Table 7.5). As in previous years, the main source of government revenues remained attributable to oil and gas revenues higher than that of 2002. Meanwhile, other revenue source i.e. net foreign loans fell (Chart 7.7).

Overall net expansion in rupiah terms was larger than revenue inflows. This shows in the withdrawal of government saving of Rp.8.3 trillion, all applied to net expansion of rupiah.



Notes:
2001-2002 : Realized State Budget; 2003 : Temporary realization per January 9, 2004
Source : Ministry of Finance (processed)

Chart 7.6
Development of Rupiah Impact of State Budget



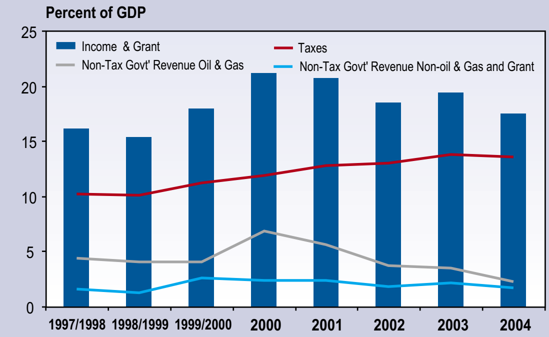
Notes :
2001 to 2002 : Realized State Budget; 2003: temporary realization per January 9, 2004
Source : Ministry of Finance (processed)

Chart 7.7.
Development of Foreign Exchange Impact on State Budget

Table 7.6
State Budget Assumptions

Assumption	2003 Realization Temporary[1]	2004 Budget
1. Annual economic growth (%)	4.1	4.8
2. Inflation (%)	5.06	6.5
3. Average exchange rate (Rp/$)	8,577	8,600
4. Average 3 months SBI rates (%)	10.2	8.5
5. International oil price ($/barrel)	28.75	22
6. Indonesia oil production (million of barrels/day)	1.09	1.15

1 Preliminary realization per January 2004 (Ministry of Finance Press Release, January 9, 2004),
Sources : Ministry of Finance (proceseed)



Notes :
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1997/1998 to 2002 : Realized State Budget; 2003: temporary realization per January 9, 2004;
2004 : State Budget
Source : Ministry of Finance (processed)

Chart 7.8
Composition of Government Revenue to GDP

PROSPECT FOR THE 2004 STATE BUDGET

Government fiscal operations in 2004 are estimated to result in a deficit of Rp24.4 trillion or 1.2% of GDP, a large decrease from the deficit in 2003 (1.9% of GDP). One of the most important factors is the international oil price. In 2004, the oil price in the budget is assumed to be lower than the realization in 2003 which affects the budgeted outcomes on both revenue and expenditure sides (Table 7.6).

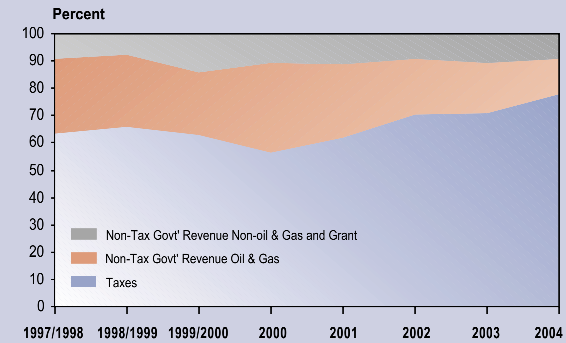
Fiscal policy in 2004 as reflected in State Budget constitutes part of medium-term fiscal consolidation program as elaborated in the Post-IMF Economic Policy package. In this package the budget deficit is targeted to gradually decline and be balanced by 2005-2006. To achieve this requires several measures including: reforms and modernization of national tax system to create a reliable revenue source, increased efficiency in government expenditures, the development of an effective debt management system and the reduction of the government debt to GDP ratio (*Box*: *Managing the Government Debt*). As in 2003 we estimate a continued primary balance surplus and continued declines in the government debt to GDP ratio to support efforts to achieve fiscal sustainability (Table 7.7).

State Revenues and Grants

After increasing in 2003, the ratio of state revenues and grants to GDP is expected to fall to about 17,5% in 2004 (Table 7.7). This fall occurs in both the tax and non-tax revenue ratio (Chart 7.8).[9]

The tax ratio is predicted to be a bit lower than the 13.8% achieved in 2003 at 13.6%. This is mainly due to lower oil and gas corporate tax revenue (in line with lower budgeted oil and gas prices), while other tax to GDP ratios are constant.

Although tax ratio is expected to fall, tax revenue is still expected to increase, both in nominal terms and as a



Notes :
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1997/1998 to 2002 : Realized State Budget; 2003: temporary realization per January 9, 2004;
2004 : State Budget
Source : Ministry of Finance (processed)

Chart 7.9
Government Revenues by Composition

9 Detail information pertaining to government expenditures is available on Appendix F, Table 31

Tabel 7.7
Development of Government Financial Operation

(Trillions of Rp)

Items	2003 Realization Temporary[1]		2004 State Budget	
	Nominal	% GDP	Nominal	% GDP
A. Government Revenues and Grants	**341.1**	**19.4**	**349.9**	**17.5**
I. Domestic Revenues	**340.7**	**19.4**	**349.3**	**17.5**
1. Tax Revenues	**241.6**	**13.8**	**272.2**	**13.6**
2. Government Revenues Non-taxes	**99.0**	**5.6**	**77.1**	**3.9**
a. Oil	42.6	2.4	28.2	1.4
b. Gas	19.0	1.1	15.8	0.8
II. Grants	**0.4**	**0.0**	**0.6**	**0.0**
B. Government Expenditures	**374.8**	**21.3**	**374.4**	**18.7**
I. Central Government Expenditures	**254.1**	**14.5**	**255.3**	**12.8**
1. Routine Expenditures	**189.1**	**10.8**	**184.4**	**9.2**
a. Personnel expenditures	47.3	2.7	56.7	2.8
b. Material expenditures	13.9	0.8	17.3	0.9
c. Interest payments	69.2	3.9	65.7	3.3
d. Subsidies	43.9	2.5	26.4	1.3
e. Other routine expenditures	14.8	0.8	18.4	0.9
2. Development expenditures	**65.0**	**3.7**	**70.9**	**3.5**
II. Regional expenditures	**120.7**	**6.9**	**119.0**	**6.0**
C. Primary Balance	**35.6**	**2.0**	**41.2**	**2.1**
D. Budget Surplus (Deficit)	**-33.7**	**-1.9**	**-24.4**	**-1.2**
Statistical Discrepancy	0.0		0.0	
E. Financing	**33.7**	**1.9**	**24.4**	**1.2**
I. Domestic Financing	**32.1**	**1.8**	**40.6**	**2.0**
1. Domestic banks financing	**8.3**	**0.5**	**19.2**	**1.0**
2. Non-domestic banks financing	**23.9**	**1.4**	**21.4**	**1.1**
a. Privatization proceed	7.3	0.4	5.0	0.3
b. Recovery of bank asset	19.7	1.1	5.0	0.3
c. Government bonds (Net)	-3.1	-0.2	11.4	0.6
- Issuance	11.3	0.6	32.5	1.6
- Due	-6.2	-0.4	-21.1[2]	-1.0[2]
- Buyback	-8.3	-0.5	-	-
II. Foreign Financing -Net	**1.6**	**0.1**	**-16.1**	**-0.8**
1. Gross drawing	**17.7**	**1.0**	**28.2**	**1.4**
a. Program aid	1.8	0.1	8.5	0.4
b. Project aid	15.9	0.9	19.7	1.0
2. Amortization	**-16.1**	**-0.9**	**-44.4**	**-2.2**
Memorandum Item:				
Total Government Debt to GDP Ratio [3]		68.0		60.0

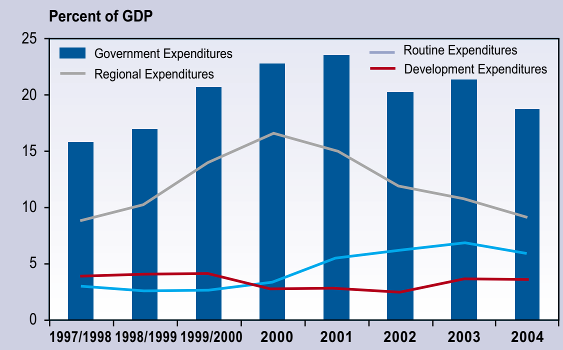
Notes :
1 Preliminary realization per January 2004 (Ministry of Finance Press Release, January 9, 2004)
2 Including *buyback*
3 Including Government Securities and Bonds, Excluding IMF Loans
Sources : Ministry of Finance (proceseed)

share at 78% of the total revenues (Chart 7.9). An increase in tax revenues especially non oil & gas income and value added taxes are not expected to interfere with business activity since they will not be attained by rate hikes but rather reforms tax and excise administration systems.[10] Excise revenue targets are approximately similar as last year, there are no increase in rates cigarette prices expected.

The non-tax revenue to GDP ratio is predicted to fall from 5.6% in 2003 to 3.9% in 2004 due to lower oil and

10 The objective of tax administrative reform is to achieve effective tax collections and to broaden the tax base without waiting for the tax law amendment. Such efforts including (a) improving tax rules in accordance with the dynamics of business environment, thus creating favorable investment and trading climate; (b) continuing the expansion of tax payer scope; (c) enhancing law enforcement and tax payer intensifications; (d) improving services to tax payers and (e) imposing code ethics within Directorate General of Taxation. The objective of custom reform is to boost economic growth and to facilitate trading activities. Efforts were made to develop custom information system, abolish smuggling activities, improve personnel integrity, and enhance supervisory system to enforce custom and duties as well as improve the effectiveness of verification and audit through the establishment of criteria for export and import documents among related institutions

gas revenues while other revenues remain constant in GDP terms. (Chart7.8). The lower target for oil & gas revenues is driven by the assumption of lower international oil prices in 2004, in line with the forecasted production recovery in oil producing countries such as Venezuela and several non-OPEC economies, Russia's plan to increase its production, and increases in Iraqi's oil production. For these reasons, it is assumed that excess supply will bring down prices. On the other hand, it is assumed that domestic oil production will remain as in the previous years, namely about 1.1 million barrels per day.



Notes :
1997/1998 to 2000 : Fiscal Year; 2001 to 2003 : Calendar Year
1997/1998 to 2002 : Realized State Budget; 2003: temporary realization per January 4, 2004;
2004 : State Budget
Source : Ministry of Finance (processed)

Chart 7.10
Composition of Government Expenditure to GDP

State Expenditures

After increasing in 2003, the ratio of government expenditures to GDP in 2004 is expected to fall to 18.7% of GDP (Table 7.8). This decline occurs in all components with largest fall in the share of routine and regional expenditures to GDP.[11]

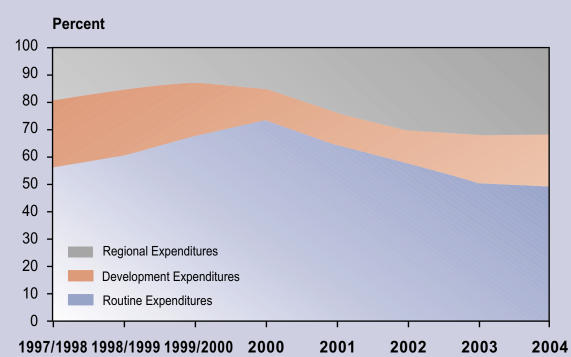
Lower routine and regional expenditure ratios are related to the assumption of lower international oil prices which reduce expected fuel subsidies and regional transfers. In addition, as in 2003 positive monetary developments (lower SBI interest rates) and measures to reduce government bonds reduce domestic debt interest payments (Chart 7.10). A lower routine expenditure as a share of GDP allows room to reduce the deficit. According to the Propenas Act, subsidies in fuel and power sectors should be eliminated from 2004. However the 2004 State Budget continues to provide subsidies although at significantly lower amounts compared to 2003. Failure to eliminate these subsidies

Table 7.8.
Impact of Government Financial Operations on The Real Sector

(Trillions of Rp)

Items	2003		2004	
	Nominal	% GDP	Nominal	% GDP
I. Revenues (T)	**260.3**	**14.8**	**292.2**	**14.6**
Tax (excl. income tax oil and gas)	222.8	12.7	259.0	13.0
Domestic Revenues Non-taxes (excl. oil and gas)	37.5	2.1	33.1	1.7
II. Expenditure (G = C + I + Tr)	**350.4**	**19.9**	**347.3**	**17.4**
A. Government Consumption (C)	152.8	8.7	165.9	8.3
Domestic Personnel Expenditures	46.4	2.6	55.2	2.8
Domestic Expenditures	13.2	0.8	16.1	0.8
General Allocation Funds & Sharing Allocation Funds	69.1	3.9	69.3	3.5
Special Autonomy Funds and Balancing	9.3	0.5	6.9	0.3
Other Routine Expenditures	14.8	0.8	18.4	0.9
B. Government Investment (I)	107.3	6.1	113.8	5.7
Rupiah Financing	48.8	2.8	50.5	2.5
Project Aid	16.2	0.9	20.4	1.0
General Allocation Funds & Sharing Allocation Funds	39.6	2.3	39.8	2.0
Special Allocation Funds	2.7	0.2	3.1	0.2
C. Transfer Payments (Tr)	90.2	5.1	67.6	3.4
Domestic Interest Payments	46.4	2.6	41.3	2.1
Subsidies	43.9	2.5	26.4	1.3
III. Surplus / Deficit	**-90.0**	**-5.1**	**-55.1**	**-2.8**

Notes:
2003: Preliminary realization per January 2004 (Ministry of Finance Press Release, January 9, 2004), Using Assumed Proportion for DAU and DBH.
Sources: Ministry of Finance (proceseed)



Notes :
1997/1998 to 2000 : Fiscal Year; 2001 to 2003 : Calendar Year
1997/1998 to 2002 : Realized State Budget; 2003: temporary realization per January 4, 2004;
2004 : State Budget
Source : Ministry of Finance (processed)

Chart 7.11
Government Expenditures by Composition

11 Detail information pertaining to government expenditures is available on the attachment F, Table 31.

is related to the government decision to not increase fuel prices and electricity base rates in 2004 thus continuing these subsidies. The reduction in subsidies is part of a larger policy to gradually shift from untargeted price subsidies to direct subsidies to poor community for basic materials and necessities.[12]

Approximately 50% of the total state budget in 2004 is allocated to the regions and development spending, respectively about 32% and 20% of total expenditures. Meanwhile, debt interest payments stay at 18% although further declines may occur (Chart 7.11).

Deficit Financing

Although it is assumed that the deficit in 2004 will be reduced significantly compared to 2003, financing will remain a burden due to government debt obligations, both domestic and foreign. The end of the IMF program also ends Indonesia's rescheduling of principal payments on government foreign debt of about $3 billion annually. This increases the amount of foreign debt coming due in 2004 to Rp.44.4 trillion from Rp.16.1 trillion in 2003. Meanwhile, the principal debt of the government to be paid will be much bigger, namely Rp21.1 trillion (including buyback) in 2004 compared to Rp14.5 trillion, including buyback in 2003. Therefore, on the side of below the line of the state budget in 2003, the required principal debt financing will be Rp63 trillion, much bigger than that in 2003, which was Rp22.3 trillion.

On the other side, the government faces limits on financing due to the less assets to be privatized and sold by IBRA. The privatization target is reduced from the realization in 2003 of Rp.7.3 trillion to Rp5 trillion in 2004. IBRA's revenue target falls sharply from about Rp19 trillion each year for the last two years to approximately Rp5 trillion in 2004.[13] However, foreign loan disbursements are predicted to increase from the equivalent of Rp17.7 trillion in 2003 to the equivalent of Rp28.2 trillion.[14] The government will address these financing issues through (a) issuance of increased domestic and foreign obligations (Rp32.5 trillion), after paying bonds coming due this will be a surplus of Rp.11.4 trillion for financing purposes and (b) by drawing down the government's saving account at Bank Indonesia by Rp19.2 trillion (the Investment Fund Account).

With this financing strategy, it is assumed that the government debt to GDP ratio will fall to 60% of GDP.[15] Along with the commitment to lower the government budget deficit and stabilize the economic recovery, a lower government debt to GDP ratio will improve the ratings for Indonesian debt, both in term of foreign currency and rupiah. This process began in 2003 with ratings upgrades by international ratings agencies. This is expected to positively impact on government bond issuance in 2004.

Impact of Government Financial Operation on the Real Sector

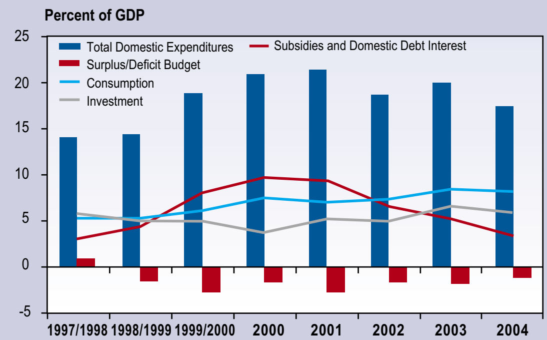
The impact of the deficit in government fiscal operations on the real sector is assumed to drop sharply from 5,1% of GDP in 2003 to 2,8% of GDP in 2004. On the expenditure side, the decrease will take place in all of its components with the largest decrease in transfer payments due to subsidy reduction and lower interest rates (Table 7.8). Meanwhile, investment spending (share

12 Based on the subsidy policy, the fuel subsidy is to be allocated for household and Small and Medium Enterprises (SMEs) fuel consumption (despite the gasoline subsidy is to be continued in 2004); food subsidy is to be allocated for rice procurement program to 8.4 million poor families; electricity subsidy is to be allocated for 20 million subscribers of social, household, business and industrial groups with installed capacity up to 450 VA; credit interest rate subsidy is to be allocated for food resilience credit scheme, interest payments on state treasury notes No. SU005, and small mortgage credit financing, and urea fertilizer subsidy to farmers.

13 Privatization will be executed through various scheme such as private placement on strategic investor, IPOs and secondary IPOs.

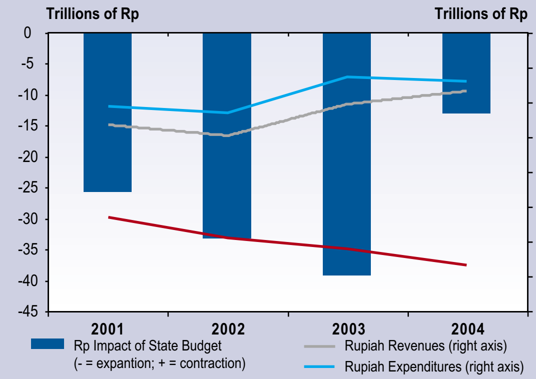
14 Foreign loans were in the form of project aid from CGI $2.3 billion and program aid from IBRD and ADB of $0.8 billion.

15 Reduction of outstanding debt, other than through the state budget, was carried out through debt swap facilities (for nature, poverty, trade and investment) as well as through bond redemption and asset bond swap



Notes :
1997/1998 to 2000 : Fiscal Year; 2001 to 2003 : Calendar Year
1997/1998 to 2002 : Realized State Budget; 2003: temporary realization per January 4, 2004;
2004 : State Budget
Source : Ministry of Finance (processed)

Chart 7.12
Composition of Domestic Government Expenditure to GDP



Notes :
2001 to 2002 : Realized State Budget; 2003: temporary realization per January 4, 2004;
2004 : State Budget
Source : Ministry of Finance (processed)

Chart 7.13
Development of Rupiah State Budget Impact

of GDP) will fall in 2004, although remain at a higher level than previous years. Lower development spending in 2004 is affected by reduced regional transfers in line with lower international oil prices, while the central government development spending ratio remains relatively constant.

The fiscal impulse in 2004 is assumed to be more contractive than previous years. In other words fiscal policy will not contribute significantly aggregated demand growths.

Table 7.9
Rupiah Impact of State Budget 2003-2004

(Trillions of Rp)

Items	2003	2004
A. **Rupiah revenues**		
Tax (excl. income tax oil and gas)	222.8	259.0
Oil and Gas (oil and gas non-tax govt'revenues and income tax)	14.0	7.8
Oil and Gas Non-taxes	37.5	33.1
Privatization proceeds	7.3	5.0
Recovery of bank assets	19.7	5.0
Government bonds	-3.1	7.9
Total revenues	**298.2**	**317.9**
B. **Rupiah expenditures**		
Operational	164.7	157.3
Domestic Personnel	46.4	55.2
Subsidies	43.9	26.4
Domestic Interest payments	46.4	41.3
Other routine expenditures	28.0	34.5
Investment	52.1	54.6
Balance budget	120.7	119.0
Total expenditures	**337.4**	**331.0**
C. Statistical discrepancy	0.0	0.0
D. **Rupiah impact (- =expansion; +=contraction)**	**-39.2**	**-13.0**

Notes:
2003: Preliminary realization per January 2004 (Ministry of Finance Press Release, January 9, 2004)
2004: Assuming international bonds is $0.4 billion. This amount is subject to change according to the markets. Using assumed proportion of oil/gas revenues and project spending.
Sources : Ministry of Finance (processed)

Rupiah and Foreign Currency Impact of Government Financial Operation

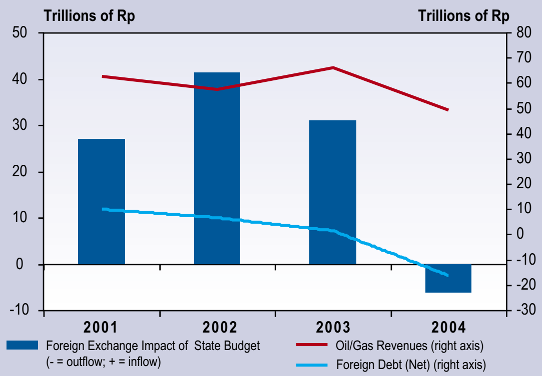
Government fiscal operations in 2004 are predicted to have an impact on the net expansion of rupiah of Rp13 trillion, lower than the impact of the previous expansion. On revenue side decline in the expansion of net rupiah is supported by increased of tax revenues and domestic bond issuance. However rupiah expenditure is not expected to fall due to lower subsidies and domestic debt interest (Table 7.9).

Tabel 7.10
Foreign Exchange Impact of State Budget 2003-2004

(Trillions of Rp)

Items	2003	2004
A. **Current Account**	**29.4**	**6.5**
Oil and Gas Revenues (oil and gas non-tax govt'revenues and income tax)	66.3	49.3
Project Aid Imports	-12.9	-16.3
Foreign interest Payments	-22.9	-24.4
Overseas Personnel Expenditures	-0.9	-1.5
External Material Expenditures	-0.7	-1.2
Grants	0.4	0.6
B. **Net Official Capital Inflows**	**1.6**	**-12.7**
Foreign Financing (Net)	1.6	-16.1
Privatization proceeds	0.0	0.0
Recovery of bank assets	0.0	0.0
International bonds	0.0	3.4
C. **Foreign Exchange Impact (A+B) (-=outflows; +=inflows)**	**30.9**	**-6.2**

Notes:
2003: Preliminary realization per January 2004 (Ministry of Finance Press Release, January 9, 2004)
2004: Assuming international bonds is $0.4 billion. This amount is subject to change according to the markets. Using assumed proportion of oil/gas revenues and project spending.
Sources : Ministry of Finance (processed)



Notes :
2001 to 2002 : Realized State Budget; 2003: temporary realization per January 4, 2004;
2004 : State Budget
Source : Ministry of Finance (processed)

Chart 7.14
Development of Foreign Exchange Impact of State Budget

On foreign exchange side, government fiscal operations are predicted to generate a considerable net outflow foreign exchange equivalent to Rp6,2 trillion (Table 7.10). This is driven by sharp falls in the two main sources of government foreign exchange revenues (oil and gas and foreign loans), although there may be new revenues i.e. an international bond. Positive net foreign disbursements will furthermore turn negative due to the end of the cooperation program with IMF (Chart 7.14). All in all it is assumed that a net expansion will result both in rupiah and foreign exchange in 2004. The government plan to draw down savings in 2004 mounting to Rp19.2 trillion used to finance these expansions.

Box Using the Fiscal Impulse to Calculate the Stance of Fiscal Policy

Some research has shown that changes in the budget balance (surplus/deficit) do not necessarily reflect a change in the fiscal policy stance. Changes in the budget balance can be driven either by changes in economic conditions or by changes in government policy through discretionary measures on either the revenue or expenditure side. If the changes were largely driven by changes in economic conditions, it is taken for granted that the fiscal policy stance is quite neutral. On the contrary, if the changes were largely driven by discretionary measures, it implies that the fiscal policy stance is intended to change aggregate demand. To determine the stance of fiscal policy, a better indicator is required. This indicator should be able to differentiate between cyclical/seasonal/temporary factors and structural factors that permanently affect state budget operations during the course of a year.

THE FISCAL IMPULSE INDICATOR

One popular indicator to measure the stance of fiscal policy is known as Fiscal Impulse (FI). This indicator provides an measure as to whether state budget policies are having an expansionary or contractionary impact on aggregate demand during some time period. It is worth noting, however, that this Fiscal Impulse indicator does not inform us of the exact magnitude of the increase or the decrease in aggregate demand. Unlike FI, the exact magnitude of the change in aggregate demand could only be obtained by measuring the multiplier impact of government consumption and investment on aggregate demand using, for example, a macroeconomic model or Input/Output analysis.

The FI indicator is constructed using the following equation:

$$FI = -\Delta B - g_0 \Delta Y^P + t_0 \Delta Y,$$

where:

FI = fiscal impulse

T = state revenues

G = state expenditures

ΔB = change in deficit/surplus $(B_t - B_{t-1})$

$B = T\text{-}G$

g_0 = G_0/Y_0, state expenditures to GDP ratio in the base year

t_0 = T_0/Y_0, state revenues to GDP ratio in the base year

ΔY^P = change in potential GDP $(Y^P_t - Y^P_{t-1})$

ΔY = change in current GDP $(Y_t - Y_{t-1})$

The above equation basically shows that the FI is the difference between the change in the actual surplus/deficit and the change in cyclically-neutral surplus/deficit. The actual surplus/deficit is the difference between the realized state revenue and spending during the course of a year. The cyclically-neutral surplus/deficit is the difference between state revenue and spending according to developments in economic conditions. The actual surplus/deficit balance results from developments in the economy plus changes in fiscal measures, whereas the cyclical-neutral surplus/deficit balance results only from developments in the economy.

Based on this concept, if there is no change in the stance of fiscal policy, the change in the actual surplus/deficit will be equal to the change in the cyclically-neutral surplus/deficit. That is, the FI will be zero. This implies that the fiscal policy stance is neutral,

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1 See Heller, Peter S., and Others, A Review of the Fiscal Impulse Measure, IMF Occasional Paper No. 44 (May 1986)

or that the change in the actual surplus/deficit is solely due to changes in economic conditions. By contrast, if the increase in the actual surplus is larger than the increase in the cyclical-neutral surplus or (if the actual deficit is smaller than the cyclical-neutral deficit balance) the FI will be negative. This implies that the government has undertaken a contractionary fiscal policy, that is, government policy has generated a larger fiscal surplus (or smaller deficit) than would have been produced by economic conditions alone. The reverse is also true. If the increase in the actual surplus is smaller than the increase in the cyclically neutral surplus, the FI will be positive. This means that the government has undertaken a smaller contractionary policy that would have been produced by the economy. It can also be expressed by saying that the government has undertaken a bigger expansionary policy than what the economy actually demanded.

CALCULATING THE FISCAL IMPULSE FOR INDONESIA

Some notes on calculating the FI for Indonesia are as follows:

1. State revenues (T) include all revenues other than oil-gas revenues (royalties and taxes) and grants. Oil-gas revenues and grants are excluded because they do not give a contractionary impact on the domestic economy.
2. State expenditures (G) include civil service salaries, government consumption purchases, subsidies, domestic interest payments, other routine, development and regional expenditures.
3. The base used is a rolling base year, e.g., a given quarter compared to the same quarter a year earlier. The annual calculation is done comparing a given year with the previous year. This is done to eliminate seasonal factors in the budget and the economy.
4. Using the method in 3., the FI calculation indicates the fiscal policy stance in a given quarter compared with the same quarter a year earlier, or annual with the year earlier.

Based on the FI concept, Table 1 indicates:

- For the 2003 budget (APBN), the FI is estimated at 0.1% of GDP, which is a relatively small number. On this basis, fiscal expansion in 2003 simply followed general economic developments.
- However, the FI for the 2004 budget is -1.8% to GDP, implying that the 2004 budget is contractionary relative to a year earlier. Stated another way, fiscal expansion is less than what the economy actually need (or there is "insufficient" expansionary fiscal impulse in the economy).

Table 1
Fiscal Impulse

Item	2002	2003	2004
I. Surplus/deficit [1]			
- in trillions of Rp	-74.5	-90.0	-55.1
II. Change in surplus/deficits (D B) period t compare to t-1[2]			
- in trillions of Rp	36.6	-15.6	34.9
- in percentage of GDP	2.3	-0.9	2.3
	Contraction	Expansion	Contraction
III. Change of Cyclically-Neutral Balance (Δ Bn) period t compare to period t-1 [3]			
- in percentage of GDP	-1.0	-0.7	0.0
	Expansion	Expansion	Neutral
IV. Fiscal Impluse = -ΔB + ΔBn [4]	-3.3	0.1	-1.8
	Contraction	Neutral	Contraction

Notes:
2002: Provisional realization as of September 2003 (Financial Notes of State Budget 2004)
2004: Provisional realization as of January 2004 (Ministry of Finance Press Conference, January 9, 2004)
1) = See table 7.3 and 7.8
2) (+) = Contraction, i.e. if current period deficits is smaller than prior deficits or if current period surplus is bigger than prior surplus.
(+) = Expansion, i.e. if current period deficits is bigger than prior deficits or if current surplus is smaller than prior surplus.
3) The (+) and (-) sign is same as note no. 1. Change in cyclically-neutral balance is calculated with formula: to* Δ actual PDB) - (go * Δ potential PDB); whereby to = income to GDP ratio and go = expenditure to GDP ratio in previous year
4) FI (+) = current period expansion compare to previous period expansion, if: expansion of ΔB is bigger than expansion of ΔBn or contraction of ΔB is smaller than contraction on ΔBn
FI (-) = current period contraction compare to previous period contraction, if: expansion of ΔB is smaller than expansion of ΔBn or contraction of ΔB is bigger than contraction on ΔBn
FI (0) = current period neutral compare to previous period neutral, if: expansion of ΔB is equal to expansion of ΔBn or contraction of ΔB is equal to contraction on ΔBn

Source: Ministry of Finance and Bank Indonesia (Processed)

Box Managing Government Debt

The soaring ratio of government (domestic and foreign) debt to GDP from 25% in 1996 to 105.4% in 2000 triggered major issues of fiscal sustainability.[1] Accordingly, PROPENAS 2000-2004 called for narrowing the deficit in the State Budget. Furthermore, Act No. 17 of 2003 on State Finance stipulates that state and regional budgets are to be prepared and executed in accordance with the spending needs of state governments and their capacity to collect state revenues.

Prudent principles of fiscal management require a balanced budget. But in certain circumstances, Central and District Governments may implement a surplus or deficit budget according to economic and state/district financial conditions. In this case, Government Regulation of the Republic of Indonesia No. 23 of 2003 (on The Control of the Amount of Cumulative Deficit of the State Budget and Regional Budget and the Amount of Cumulative Loans of Central and District Government) restricts the deficit of the State Budget and Regional Budget at a maximum of 3% of GDP in the current year. Likewise, borrowings by the Central and District Governments shall be restricted to a maximum of 60% of GDP in the current year. In order to fulfill these conditions, the government needs strong strategies and policies for domestic and foreign debt management.

On the State Budget side, the government's debt management policy stresses fiscal sustainability, implemented by: (a) widening the primary surplus by increasing state revenues and budget savings so that surpluses can be used to reduce government debt; (b) increasing state revenues through strategic steps to raise tax (that is, *the tax ratio* or taxes relative to GDP) and non-tax revenues; and (c) saving state revenues by revising the budget mechanisms in order to be efficient and by gradually reducing unproductive subsidies and expenses.

In implementation, the following opportunities are available: (a) the tax ratio in Indonesia is low compared to other countries, so that state revenues have considerable potential to increase; (b) several types of expenditures still have room for savings, including subsidies; and (c) low inflation is expected to allow further reductions in interest rates, which will reduce interest spending.

Besides the effort to increase state revenues and save on state expenses, the government is also adopting various strategies to reduce domestic and foreign debt.

FOREIGN DEBTS

The government's decision to terminate the economic recovery program with the International Monetary Fund (IMF) at the end of 2003 makes it impossible for the government to reschedule more foreign debts through the Paris Club (PC). Therefore, in the coming years the government will bear a heavy foreign debt burden. Challenges in this regard will become more difficult due to declining state revenues from some sources, such as privatization and asset recovery.

In order to respond to these challenges, some policy adjustments will be needed concerning foreign debts, as discussed below.

1 Indonesia's Medium-Term Fiscal Continuity, Bank Indonesia, 2001

- ***Implement debt swaps.***

  Options like debt reductions ('haircuts') and debt default are unpopular with creditor countries and are potentially dangerous for Indonesia. Likewise, there is limited financial capacity to perform debt buybacks. Consequently, the most feasible option to reduce the government's foreign debt—albeit to a limited degree—would be debt swaps. In order to take advantage of this opportunity, it is necessary for the government to have flexible financing and coordination between relevant departments in following up such opportunities as are available. For example, the government needs to be proactive in seeking out possibilities for debt swaps with creditors like some European countries (including Germany, England, France and Italy) that have indicated interest in these programs. Performed effectively, debt swaps could lead to a write-off of some $1.7 billion or about Rp15 trillion of Indonesia's debt. This would be a significant amount of debt relief.
- ***Initiate 'out of the box' solutions to reduce the government's foreign debt***

  The willingness of some OECD countries to look for alternative means of debt relief for middle low-income countries (like Indonesia) requires an immediate response from the Indonesian government. A joint effort by debtor countries is required to negotiate debt relief until the debt burden is down to a safe level.
- ***Improved debt management***

  In order to improve foreign debt management, it is necessary to efficiently integrate the functions of front, middle and back public relation office based on principles of prudence. Without prejudice to other functions, the focus should be on development of the middle office function in order to support debt management oriented to risk and cost management.
- ***Building an Investor Relation Unit (IRU)***

  As one of the policies supporting the front office function, an IRU, is one of the most important things to be considered. This unit will help build active communications between investors and creditors, providing information on Indonesia quickly and accurately. Through transparent and timely provision of such information, it is expected that the rating of government debt will be upgraded, thereby minimizing debt service costs.
- ***Enhancement of legal aspects of foreign debts***

  The government needs to pass an Act on Foreign Debts immediately as a legal basis for regulating the system of obtaining and using foreign debts. Such an act was discussed by the government and the House of Representative years ago without any real action plan being produced. It would function as an "early warning system" for government, and provide guidance by emphasizing prudent considerations for creditors in evaluating regional government loan proposals. With respect to regional autonomy, the government should ensure that foreign borrowings by sub-national governments are subject to approval from the central government. The main purpose would be to avoid uncontrolled drawdowns of foreign debts, which could become a national burden in the future.

DOMESTIC DEBTS

Indonesia's huge domestic debt is an indication of the cost of the economic crisis. To minimize the burden, the government should find strategies to reduce that debt (or its cost), for example by:

- Reducing the outstanding amount of recapitalization bonds by buying back those bonds using financing arising from IBRA asset disposals, the earnings from privatization of state-owned corporations, exchanging bonds for other assets through the *asset to bond swap* program and the surplus of State Budgets in the future.
- Extending the bonds' maturity structure through other countries' technical examples, using *debt exchange offers* and a *market friendly approach.* This would entail issuing long-term bonds (*refinancing bonds*) in order to buy back short-term bonds.
- Developing a liquid secondary bond market with a broad base of investors, thereby helping to absorb *refinancing bonds* in the future.

In 2002, the government began to pay off bonds as they fell due, *reprofiled* the maturity of some recapitulation bonds and exchanged some bonds using an *asset bond swap* program run by IBRA. During 2003, the government paid off bonds as they fell due; used *asset to bond swaps*; and performed bond *buybacks* and *cash to bond swaps* through IBRA.

In the future, the strategy for state debenture management should entail *refinancing* for the period of 2004-2009; extending the average maturity period of state bonds; and continuing to reduce outstanding amounts of state bonds through buybacks in the secondary market. The requisite financing could come from sales of state (formerly IBRA) assets, *asset to bond swaps*, privatizations and surpluses in the State Budget. Moreover, the government should continue balancing the maturity structure of state bonds with the market's absorptive power, while developing the secondary market.

Concerning the use of state debentures as one of the sources of State Budget funding, the government issued Act No.24 of 2002 on State Debentures, thereby providing a legal basis for the government to issue state debentures. It also provides legal assurance to investors holding state debentures, making them a safe and risk-free instrument for investments. It also provides a legal basis for the prudent, transparent and accountable management of state debentures. This law states that the purpose of issuing state debentures is to fund the State Budget deficit and to cover short-term cash shortages as a result of cash-mismatches as well as to manage the state debt portfolio.

Chapter 8:
Banks and Other Financial Institutions

Chapter 8: Banks and Other Financial Institutions

Banking policy, supported by improving macroeconomic indicators such as inflation, the exchange rate and interest rates, has helped the recovery of bank intermediation. This process has been accompanied by improvements in the performance of non-bank financial institutions. Nevertheless, intermediation has yet to reach optimal levels as reflected in considerable amounts of undisbursed bank loans.

In general, performance of the financial sector continued to improve in 2003. In the banking sector, growing third party funds and credit extensions indicate ongoing recovery in bank intermediation function, accompanied by stability in capital, profitability, and credit quality. Favourable progress also occurred within the non-bank financial institutions, that is, multi-finance companies, the state-owned pawn company and mutual funds as reflected in their business indicators and the establishment of new branches. Other financial institutions, especially multi-finance companies and the state-owned pawn company, also experienced an improvement with respect to their total assets, capital, net worth and current year profit. For the state-owned pawn company, the improvement is followed by the establishment of new branches. Similarly, the net asset value (NAB) of mutual funds during the reporting period recorded a remarkable improvement.

In the banking sector, improvements were attributable to banking policies adopted, banks' internal consolidation, and improvements in various macroeconomic indicators such as inflation, the exchange rate and interest rates. In general, Bank Indonesia continues to adopt policies as last year, those are improving banks health and strengthening banking system resilience, and improving credit expansion to micro-, small- and medium-scale businesses (UMKM). These policies aim to enhance the recovery of banking intermediation.

Improved performance during the reporting year is an evidenced of the banking sector's success in meeting various challenges and risks within the industry. The ongoing recovery in intermediation competed with rapid development of the capital market and the low capacity of the corporate sector to absorb bank credits. As for funds mobilization, rapid development in the stock market and mutual funds have competed with banks for mobilization of third party funds. Meanwhile, as regards to credit extension, bank encounters competition from alternative corporate financing such as stock and bonds issuance. The impact could be seen in rising undisbursed loans and a drop-off in credit extensions during 2003.

In addition to such challenges, the banking sector had to deal with other issues. For example, while eager to expand credits, banks had to carefully control risks, especially as concerns the potential for deterioration in the quality of credits. In facing such challenges, Bank Indonesia continued to encourage banks to improve their application of risk-based management principles. In accordance with improving risk-based management, several regulations were issued as guidelines with reference to the 25 Basle Core Principles. Better risk management would result in the stable quality of credit, capital and higher profitability.

Improvements in banking and financial system indicators gave evidence that banking and financial system stability had generally been maintained. Financial system stability, supported by improved macroeconomic indicators, helped to re-build domestic and international confidence in prospects for Indonesian economic growth.

BANKING

In 2003, Bank Indonesia policy towards the banking sector remained focused on bank restructuring and improving banking resilience, while continuing efforts undertaken after the on-set of the banking crisis in 1997. Shortly after the crises broke, policies has been focusing on regaining public confidence in the national banking system. As follow-up, policies to improve banks' internal financial condition are adopted through the recapitalization program, which absorbed major amounts of state budget resources.

After recapitalization and in line with improved banking conditions, the next step was the divestment of government shares in the banking system. In addition to reducing the government burden of coupon payments on recapitalization bonds, the divestment program would also improve efficiency and performance of overall banking sector. On the next stages, the formulating rule of law has become crucial to maintain the improvement of banking conditions and enforce prudential banking principles. In support, Bank Indonesia has pioneered the implementation of various regulations referring to international banking practices (the 25 Basle Core Principles).

Past and prospective policies will be successful if a sound banking environment and effective supervision are put in place. Bank Indonesia, as the banking authority, is fully aware of these considerations in defining its agenda. In a wider scope, Bank Indonesia's policy will be improved and integrated within the Indonesian Banking Architecture framework(*Box: The Indonesian Banking Architecture: Strategy to Establish a Sound Banking Industry*). This will be used as guidance and the basis for policy in long term development of banking in Indonesia.

To realize financial system stability in Indonesia, during the reporting year Bank Indonesia established the Financial System Stability Bureau (BSSK) and initiated steps to form a Financial Safety Net. Along with those commitments, Bank Indonesia continued to encourage the recovery of bank intermediation while observing prudential principles. Further efforts in this regard include the empowering the Micro-Small- Medium Enterprises (UMKM) and strengthening the sharia and rural credit banks (BPR) networks.

Various banking polices, supported by improved macro indicators (such as a stronger exchange rate, lower inflation and declining SBI rates) have boosted banking's overall performance. As regards the conventional banks, improved performance was reflected in higher deposits, credits, LDR (loan-to-deposit ratio), and profitability, as well as stable CARs and NPLs. As regards sharia banks, improvements were reflected in expanding assets, deposits, and credit extensions besides a wider office network. During the reporting period, the sharia banks were able to record a remarkable pace of asset expansion, the highest in the past 3 years. This indicates an increasing public preference for sharia banking, supported by aggressive socialization, education and promotions conducted by Bank Indonesia, the sharia banks and universities. For their part, BPRs' assets, third party funds, credit and capital, all improved during the reporting year. Moreover, there was continued investor confidence in BPRs' prospects as indicated by the higher number of proposals for BPR licensing.

Despite these many improvements, intermediation has yet to return to normal as reflected in undisbursed loans and low LDRs. As of end-November 2003, undisbursed loans had reached 22.5% of total credit, while the LDR was only 43.7%, far below the average of 75% during the pre-crisis period.

Banking Policy

In broad, banking policy in 2003 continue to focus on: **(1) bank restructuring program**, including government blanket guarantee scheme for public banks and BPR, recapitalization of commercial banks and debt restructuring; and **(2) building resilience of banking system** that covered development of banking infrastructure, improvement in good corporate governance, as well as improvement in banking regulations and bank supervision. In addition, in order to restore the intermediary functions, Bank Indonesia involved in **(3) developing UMKM.**

Bank Restructuring Program

The policies adopted in bank restructuring area during 2003 were geared towards the continuation of government blanket guarantee scheme, re-capitalization of commercial banks and debt restructuring programs. Under this **blanket guarantee scheme**, during the reporting year, repayment of principal and interest of interbank exchange offer amounts $196.2 million. Meanwhile, in continuation of the blanket guarantee scheme for the BPR, up to July 2003, the total amount of payment for third party fund from the 98 frozen BPRs during 2001, 2002 and 2003 reached Rp.82.5 billion.

In the last several years, **recapitalization program** has entered into a divestment phase. During the reporting year, government had divested the shares of Bank BCA, Bank Niaga, Bank Danamon, BII (approximately 51%), so that government no longer became the majority shareholder. In the same period, the government had also privatized State-Owned Banks, i.e. Bank Mandiri and Bank BRI although it remained as majority shareholder. In addition, there was a plan to privatize Bank BNI. The proceeds from these divestments had been utilized to finance fiscal deficit rather than reducing recapitalization bonds.

During 2003, the value of recapitalization bonds under trade portfolio increased by Rp. 50 trillion. Up to 30 September 2003, 62,4% out of the total recapitalization bonds of Rp.389.2 trillion was in the form of investment portfolio and 37.6% was in the form of trade portfolio. This development indicated that banks has stronger expectation regarding the opportunity to utilize such recapitalization bonds for business expansion.

Debt-restructuring process had been continuing during 2003. Total amount of debt restructured up to September 2003 at 16 major banks reached Rp.41.3 trillion, Rp.7.3 trillion out of which was classified as sub-standard, doubtful and bad loan. The total amount of restructured debts was Rp.50.2 trillion , slightly declined compared to that at the end of 2003. Debt restructuring still faced several problems, among others: (i) difficulties in restructuring loan syndication as the management thereof involved the Indonesian Bank Restructuring Agency (IBRA) and several banks with varied capacities; (ii) settlements of debtor's liabilities were related to debtors (group) of other banks and/or IBRA, and (iii) legal certainty in execution of collateral, for example, problem in bank liquidation should there be collateral held simultaneously by banks and IBRA.

Building Resilience into the Banking System

Building resilience into the banking system was put in place through: (a) banking infrastructure development; (b) quality improvement of bank management; (c) improvement of banking regulations; as well as (d) enhancement of banking supervisory system.

Banking Infrastructure Development

Banking infrastructure development included development of BPR, sharia banks, as well as establishment of a Depository Guarantee Agency (LPS). In the context of **BPR development**, Bank Indonesia adopted the following five strategies: industrial restructuring program, improvement of regulations and supervision, preparations of blue-print, capacity and institutional strenthening, as well as infrastructure support.

In the context of capacity and institutional strengthening, a National Task Force (NTF) was set up in the reporting year. The NTF is an embryo of Standard Certification Board which is part of certified training system development in order to systematically and continuously improve BPR human resources. Members of NTF were Bank Indonesia, Indonesian Banker's Institute, Central Management Board of Perbarindo and several Regional Boards of Indonesian BPR Association, as well as GTZ. In addition, Bank Indonesia also gave technical assistance to commercial banks in the form of training on BPR and provided proper information on BPR by referring to criteria of Micro-Credit Project (PKM). Other policies included the enhancement of BPR operations by encouraging utilization of adequate information technology and promotion of consumer's protection and empowerment. This effort was made, among others, by forming an Arbitration Agency to settle issues between BPR and customers as well as obliging BPR to form a service unit on customer complaints.

The sharia banking policy during 2003 was an implementation of the Indonesian **sharia banking development** blue print launched in 2002. Such blue-print consisted of three stages of implementation, i.e.: Stage I 2003 – 2004, laying out strong development foundation for the growth of Bank Sharia; Stage II 2004-2008, strengthening the structure of sharia banking industries; Stage III 2008-2011, complying financial standards and international service quality.

In accordance with the first stage of Indonesian Sharia Banking Development blueprint, Bank Indonesia policy during the reporting period had been focused on formation of basic framework for regulations adapted with characteristic of sound banking operations. This is done, inter-alia, by improving the regulations and promoting public awareness on sharia banking. In order to improve such basic framework for the regulations, a number of regulations had been issued during the reporting period. The regulations related to Earning Assets Quality (KAP), Short Term Financing Facility (FPJP) of Sharia Banks, Accounting Standard of Sharia Banks, and Monthly Statement of Sharia Banks. As regards to improve public awareness on sharia banks, several actions had been taken, among others, formation of Sharia Economic Communication Center (PKES) and socialization program in cooperation with various parties such as college/ universities, MUI, and public institutions.

On September 30, 2003, Bank Indonesia had conducted International Conference on Islamic Banking: Risk Management, Regulation and Supervision under the theme of Toward an International Regulatory Convergence As part of supporting development of sharia banking (*Box: International Conference on Sharia Banking*). Such conference was conducted in cooperation with The Ministry of Finance of the Republic of Indonesia, and the Islamic Development Bank (IDB) with the purpose of providing an international forum to express ideas and discuss the relevance of sharia banking in the context of creating financial system stability, understanding unique characteristics of sharia banking business risks, risk management as well as supervisory system in sharia banking.

In relation to KAP regulations and Loan Loss Provision (PPAP), in the reporting year Bank Indonesia issued two Regulations of Bank Indonesia (PBI).[1] These Regulations of Bank Indonesia were issued because some products of

1 PBI No. 5/7/PBI/2003 concerning Earning Assets Quality (KAP) for Sharia Bank and PBI No. 5/9/PBI/2003 concerning Provision for Earning Assets Write off for Sharia Bank. Both PBI were signed on May 19, 2003.

sharia banks were quite different from those of conventional banks. These regulations aim to form common perception of all actors, including the regulators, in measuring risk level of each financing facility provided. Formulation of these provisions reflects Bank Indonesia's effort to provide regulatory instruments in compliance with the underlying sharia principles.

In order to improve effectiveness in provision of short term financing facility and as manifestation of the lender of the last resort function, Bank Indonesia issued regulation concerning FPJP for sharia banks which governs the mechanisms and procedures in provision of short term financing facility for sharia banks.[2] Similar to conventional banks in performing their intermediary functions, bank sharia also encountered liquidity risk of short-term financing caused by mismatches between the cash inflows and outflows. Hence, the regulation on FPJP was issued to anticipate such situation. To cope with such short term financing issues, sharia banks should first seek funds at inter-bank money market based on sharia principles (PUAS) by employing various money market instruments available. Particularly for any Sharia Business Unit (UUS), besides seeking funds at PUAS, sharia banks may also attempt to obtain funds from the head office of their conventional commercial banks. In case the sharia banks failed to get funds either from the PUAS or from the head office of their conventional banks, then Bank Indonesia as the lender of last resort could provide financing based on the sharia principles. Such financing facility should be pledged under high-valued, easily disbursable, and sharia compatible collateral such as SWBI. The main objectives in provision of this facility were to maintain viability of the bank business and stability of the payment system. For such purpose, this financing facility should only be provided to any bank that suffered from short-term difficulties, but qualified the solvency level and capitalization requirements (illiquid but solvent).

To provide guidelines and reference for sharia banking accounting, Bank Indonesia cooperated with the Indonesian Accountant Association (IAI) and practitioners of sharia banking to formulate a financial accounting standard for sharia banks in 2002. Such standard had been issued in the form of the Statement of Financial Accounting Standard (PSAK) No. 59, effective by January 1, 2003. Then, based on PSAK No. 59, Bank Indonesia had also issued the Indonesian Sharia Banking Accounting Guidelines (PAPSI) through Circular Letter (SE) No. 5/26/BPS on October 27, 2003 concerning Application of PAPSI. PAPSI constituted guidelines for the banks in preparing and issuing their financial statement.

Issuance of PSAK No. 59 on Sharia Banking Accounting System constituted a new historical milestone for development of a solvent, prudential and sharia compatible banking system in Indonesia. PSAK No. 59 was formulated with reference to accounting standard of international sharia financial institution issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Bahrain that had been reviewed by scholars, accountants, bankers and ulema (Islamic scholars). In addition, the National Sharia Board (DSN) had also express its opinion regarding sharia conformity of the said guideline. Hence, PSAK No.59 possessed high credibility in terms of both the accounting and sharia aspects.

In December 2003, Bank Indonesia had also issued provisions on monthly report for sharia banks (LBUS).[3] Formulation of such LBUS was based on PSAK No.59 and PAPSI. Upon the issuance of the LBUS regulation, now sharia banks and UUS are obliged to submit their monthly reports to Bank Indonesia in a specific and different format

2 PBI No. 5/3/2003 dated October 4, 2003

3 The regulation is formulated in PBI No. 5/26/PBI 2003 concerning Sharia Bank Monthly Report, External Circular Letter No. 5/31/DSM dated December 1, 2003 concerning Sharia Bank Monthly Report, and Internal Circular Letter No. 5/59/Intern concerning Guideline for Sharia Bank Monthly Report

from that of conventional banks. The provision regarding monthly reports of sharia banks shall be effective three months after the issuance of the said regulation.

In order to support the improvement of public awareness on sharia banks, Bank Indonesia had facilitated the formation of PKES. PKES constituted a collaborative forum of inter-bank and non-bank sharia financial institutions to conduct socialization and public education on sharia banks and economy in a well planned, sustainable and professional approach, so as to achieve optimum efficiency and effectiveness. The PKES incorporation deed was signed on December 17, 2003. Formation of PKES was based on consideration of the importance of socialization and public education in encouraging the growth of sharia banks, improving customer services to promote accountability of sharia financial industries, and supporting stability of the sharia financial system.

Following up the plan to establish a **Depository Guarantee Agency (LPS)**, Bank Indonesia, Department of Finance and IBRA have agreed to reactivate the Working Group for Preparation of LPS Establishment. The reactivation was deemed necessary so that a concept of a Government-based deposit guarantee agency, to operate after the closing down of IBRA, can be immediately formulated.

The Working Group of LPS Establishment Preparation, together with the Cabinet Secretariat personnel, had intensively conducted discussions to formulate a final concept of the Bill concerning LPS. The discussions were important in order to prepare the regulatory materials for effective implementation of the Indonesian Financial Safety Net (IFSN) simultaneously with the Bill on Financial Supervisory Authority and amendment of Bank Indonesia Act. It is estimated that in early February 2004, the Government and Bank Indonesia will sign a Memorandum of Understanding on implementation of the lender of the last resort function.

Enhancement of Bank Management Quality (Good Corporate Governance)

Bank Indonesia continuously encouraged banks to perform good corporate governance through, among others, bank owners and management selection (through fit and proper test program and interviews to those prospective owners and bank management), appointment of compliance directors, and criminal investigation on banking sector.

During the reporting year, Bank Indonesia have conducted **fit and proper tests** towards 17 persons of bank management, so that since 1999 a cumulative total of 1,166 persons consisting of 93 owners (shareholders) and 1,073 bank management personnel had been evaluated. In the same period, Bank Indonesia had interviewed 4 prospective owners and 169 prospective personnel for bank management. Four prospective owners and 140 prospective management personnel passed the interview. In general, the passing criteria was determined by the three factors, i.e. integrity, competency, and compliance with prevailing provisions.

After Bank Indonesia set out that each bank should have **a Compliance Director**, since July 1999 up to September 2003, around 160 banks (including Frozen Banks/Business Activities (BBO/BBKU) and merged banks) had submitted around 297 candidates. The evaluation results are: 227 candidates had been approved, 43 denied, 7 candidates had been under evaluation process, and 20 candidates disqualified.

During the reporting period, Special Unit for Banking Investigation (UKIP) of Bank Indonesia had been improving coordination with the National Police (POLRI) and Attorney General of the Republic of Indonesia in the context **of handling crime in banking sector** as well as suspicious transactions (STR) indicating money laundering. STR handling by Bank Indonesia constituted a follow up of paragraph (3) of Article 45 of Act Number 15 of 2002 concerning the Money Laundering Crime, that authorize Bank Indonesia to perform tasks of Indonesia Financial Transaction Report and Analysis Center (PPATK) especially with respect to banks until October 18, 2003, i.e. until the PPATK come into full operation. During 2003, UKIP had received 266 STR reports from 29 banks. Around 53 reports had been submitted to the National Police (POLRI), 71 reports had been handled by UKIP, and 142 reports not followed up. Such reports were not followed up because, among others, the account had been closed, account owner identities were incomplete and weak indication of money laundering crime.

To expedite investigation process against such alleged offense in banking sector, Bank Indonesia officers were expected to reserve authority as Civil Servant (PNS) investigators, as had been granted to Customs and Excise as well as Bapepam apparatus under the prevailing legislations.

Improvement of Regulations

During the reporting year, Bank Indonesia had issued 11 **regulations in banking sector** covering supervisory system, prudential banking, banking liquidity, and government guarantee. Three of those regulations were specifically related to sharia banking practices, two regulations on BPR and six regulations on conventional banking with the following details:

- The regulations issued under the scope of supervisory system covered the KAP of sharia banks, PPAP of sharia banks, obligations to provide educational and training funds for human resources development of BPR, net foreign currency position (PDN), and application of "Know Your Customers" principle.[4]
- The regulations issued under the scope of prudential banking covered prudential principles in equity investment, application of risk management for banks, and capital adequacy minimum provision, taking into account market risks.[5]
- Regulations issued under the scope of bank liquidity covered FPJP of sharia banks and FPJP of conventional banks.[6]
- In relation to government guarantee scheme, the regulations issued covered determination of interest rate margin of third party funds in guarantee scheme, and requirements and procedure for executing government guarantee against BPR liability payment. As per November 1, 2003, interest rate margin of third party funds guaranteed by Government, either Rupiah or foreign currency deposits, is set to be equal to average of time deposit interest rate of *Jakarta Inter-bank Offered Rate* (JIBOR) bank member as selected by Bank Indonesia. Provisions on requirements and procedure to execute government guarantee scheme against BPR liability payment had been issued for the purpose of recovering and promoting public trust toward BPR.[7]

Enhancement of Bank Supervisory System

In the area of **enhancement of bank supervisory system,** Bank Indonesia regularly sought to improve compliance level toward 25 *Basel Core Principles*. In the reporting year, Bank Indonesia issued a policy requiring each bank to formally apply risk management. The requirement intend to allow banks to make projections and adopt policies to anticipate potential loss in the future. Such provisions would be applied in stages and would be formally enforced in early 2005.

Bank Indonesia also modified capital provision by incorporating market risk component in Capital Adequacy

4 PBI No. 5/8/PBI/2003 dated May 19, 2003; PBI No. 5/9/PBI/2003 dated May 19, 2003; PBI No. 5/14/PBI/2003 dated July 23, 2003; PBI No. 5/21/PBI/2003 dated October 17, 2003.

5 PBI No.5/10/PBI/2003 dated June 11,2003, PBI No.5/8/PBI/2003 dated May 19,2003 PBI 5/12/PBI/2003 dated July 27,2003

6 PBI No. No.5/3/PBI/2003 dated February 4,2003, No.5/15/PBI/2003 dated August 14, 2003

7 Circular Letter No. 5/25/DPNP dated October 23, 2003.

Ratio calculation in the middle of 2003 with a transitional period until the end of 2004. Such regulations were introduced in order to improve banks' resilience against the fluctuations of interest rates and exchange rates. Formally, such regulations would be effective in 2005 to give ample time for banking to make necessary preparations.

In performing its tasks as a banking supervisory authority, Bank Indonesia has been conducting general audits to 69 banks and special audits to 17 banks in the reporting period. Such special audits, among others, covered fit and proper test audit, capital audit, audit toward KAP and application of "Know Your Customer" principles.

Development of Micro-, Small- and Medium Scale Business Credit (UMKM)

The roles of Bank Indonesia in UMKM development carried out through three approaches, i.e.: (1) banking credit policy; (2) institutional development; and (3) technical assistance provision.

The limited access of UMKM to bank's services indicated impediment to optimal bank intermediary function. In response to this, during the reporting year, Bank Indonesia made efforts to develop UMKM with emphasis on improvement of UMKM access to bank's services. Through **credit policy** approach, Bank Indonesia endeavored to encourage commercial banks and BPR to enhance their credit extension UMKM according to the business plans of the respective banks, taking into account the prudential principles.

In business plan of 2002, 14 commercial banks controlling 80% of national banking assets (*Systematically Important Banks*) and BPR, target credit extensions of Rp 30.9 trillion to the UMKM sector. The actual amount turned out to be Rp.35.9 trillion or 116% of amount targeted. For 2003, the banks planned to increase their credits to UMKM to Rp.42.5 trillion, consisting of Rp.7.5 trillion (17.7%) for micro-scale business, Rp.15.2 trillion (35.8%) for small scale business, and Rp.19.7 trillion (46.5%) medium-scale business.

Besides encouraging banks to extend credits to UMKM, Bank Indonesia also supported UMKM financing through provision of Bank Indonesia Liquidity Credit (KLBI) re-lending within the program credit framework by the Coordinating BUMN that managed the KLBI. This was a follow-up of article 74 of Act No.23/99, requiring the transfer of KLBI management in the context of program credit to 3 Coordinating BUMN appointed by the Government, i.e. BRI, BTN, and PT. Permodalan Nasional Madani (PNM). The three Coordinating BUMN were authorized to re-lend KLBI installment received from the executing banks until the KLBI in question became due. The total KLBI installments received by Coordinating BUMN until November 2003 was about Rp.4.1 trillion. Out of this, the total re-lending amount of KLBI installments reached Rp.2.3 trillion or 56%. Compared to that at the end of December 2002, which was Rp. 1,7 trillion, the relending amount had increased by 35%. As in the previous year, the KLBI re-lending activities were mainly carried out by PT. PNM, representing an amount of Rp.1.7 trillion (73%), through General KKPA credit schemes, KKPA Profit Sharing, KKPA for Indonesian Labour (TKI), KKPA for Fishermen, Commercial Banks KPKM, BPR KPKM, and BPR KMK.

Still in the context of KLBI re-lending, Bank Indonesia issued Bank Indonesia Regulation No. 5/20/PBI/2003 concerning Management Transfer of KLBI in the framework of Program Credit. This regulation constituted improvement of Bank Indonesia Regulation No. 2/3/PBI/2000, dated February 1, 2000, that reiterated the authority and responsibility of Bank Indonesia and Coordinating BUMN (in this case PT. PNM and BTN). In addition to the authority and responsibility, the regulations also stipulated sanctions with regards to BUMN liabilities to Bank Indonesia.

In order to help the funds availability for such program credit, Bank Indonesia had purchased Government Securities (SUP) No. 005 in the context of credit program with plafond of Rp.9.9 trillion at end of December 1999. Up to the end of December 2003, the available funds amounted Rp.3.1 trillion, of which Rp.850 billion had been withdrawn by the Government, leaving plafond at Rp.2.2 trillion. The terms of SUP is 10 years and it will expire on December 10, 2009. The SUP bears interest rate equals to that of 3-month SBI. In view of the short time available to re-lend those funds, the government through the Ministry of Finance had requested for deadline extension for SUP withdrawal. The request has been approved by Bank Indonesia; hence, the deadline for SUP withdrawal has been extended from previously May 10, 2003 to May 10, 2004.

On the **institutional approach,** Bank Indonesia has sought solutions to improve banks' intermediary function and real sector recovery such as holding a Western-part Indonesia Dialogue Forum (FD-KBI) on February 21 – 23, 2003 in Bukit Tinggi, West Sumatera. Such a Forum constituted a tripartite meeting between the government, banks and business sector, and is part of a serial activities previously conducted in Eastern Indonesia (KTI) on November 8 – 11, 2002 in Makassar.

One of the recommendations and solutions made in the FD-KBI was the utilization and development of a credit insurance agency to overcome issues regarding less-bankable customers of UMKM. As a follow-up, a one-day seminar and focused discussion on Credit Insurance Agency was held on October 20, 2003. One of the key resolutions of the seminar, attended by relevant agencies, banks, and business players, was "empowerment and enhancement of the existing credit insurance agency, supported by appropriate regulatory apparatus".

In addition, as in the previous years, Bank Indonesia has conducted intermediary bazaars aimed at introducing banks to small- and medium-scale business (UKM). Such events have been conducted in Denpasar, Bandung, Cirebon, Tasikmalaya, Bengkulu, Pekanbaru, and Batam.

To support the development of Micro- and Small-Scale Business (UMK), Bank Indonesia deemed it necessary to expand its role in the provision of **technical assistance,** which to date has been provided only to banks. Such services were formulated under Bank Indonesia Regulation No. 5/18/PBI/2003 on the provision of technical assistance in the light of development of UMK. This technical assistance stresses services to overcome limited accessibility of UMK to financial institutions, especially banks.

Before issuance of that regulation, technical assistance was provided only to the banking sector, but now it has been extended to the real sector through the Business Development Services Provider (BDSP). Bank Indonesia utilized BDSP because the large number UMK, constituting the final target, can not be accessed directly by Bank Indonesia. BDSP, as the intermediary, would further develop, assist, and facilitate the UMK. In this new Bank Indonesia Regulation, it is mentioned that technical assistance provided by Bank Indonesia would be focused on training and the provision of information, which is to be implemented in the following framework:

- Technical assistance is provided to the bank and the services provider;
- Technical assistance is provided in the form of training and the provision of information.
- Training covers aspects of individual micro- and small-scale credit extensions; collective micro- and small-scale credit extensions; and issues on financial aspect.
- Provision of information covers data on credit statistics; data on commodities in a region which has potential for development; data on commodities potential for export; a financing model for potential commodities funding; and other information relevant to UMK development.

In order to support the technical assistance, during 2003 several pieces of research related to UMK were carried out by Bank Indonesia. One of these was on the Impact of the Micro-Scale Business Lending Model on Bank's and Customer's Performance. Conclusions from this research were:

- The micro-credit development model did not result in operational cost burden for the bank concerned, but had become a profit center, instead.
- The lending model adopted by banks had a positive impact on micro-businesses, which could be seen from the improved performance of such micro-businesses.
- The micro-credit lending model adopted by Bank BNI had promoted participation of micro-business players in the banking sector.
- Micro-business in principle were not so sensitive to interest rates on credit; rather, they were more concerned with punctuality, needs, and simple process in obtaining credit.

Other studies undertaken were the Baseline Economic Survey (BLS) and a Study on Potentially Exportable Agroindustry Commodities. These studies were conducted in order to furnish information on the profiles of regional economic activities, sectoral analysis and small-scale analysis for three provinces, i.e. Bali, Riau and the Riau Islands. In addition, the studies updated data on the BLS Information System (SIB) and Export-oriented Agroindustrial Information System (SIABE) in Bali and Riau provinces in order to improve the Small-Scale Business Development Information System (SIPUK). The SIPUK itself presents information and data covering SIB, SIABE, the Information System Lending Model (SILM), the Information System for Investment Decisions (SPKUI) and the Information System on Credit Application Procedures (SIPMK). These provide information to banks, regional governments, related agencies/services and the general public on small-scale business development. They are accessible through the internet at Bank Indonesia's website.

In the reporting period, Bank Indonesia also conducted research on a Small-Scale Business Lending Model. The objective of this research was to provide a reference for banks in financing certain commodities of small-scale businesses (UMK) and to provide information and practical knowledge for UMK on certain commodity cultivation in line with the policy of relevant government departments. At present, the research on lending model undertaken by Bank Indonesia covers 56 commodities.

In view of the increasing role of UMK in the domestic economy, on February 22, 2003 a joint agreement was signed between a Deputy Governor of Bank Indonesia and the KPK Secretary on Formation of a Task Force on Financial Consultant Empowerment/Bank Counterpart UMKM Assistance (KKMB). The aim of this taskforce was to empower, facilitate and coordinate KKMB services with the bank to seek wider UMKM access to banking funds. In this case, Bank Indonesia played the role of facilitator in a taskforce whose membership consisted of banks (including BPRs), banking associations, technical agencies that provided assistance to UMKM (Offices of the State Minister of Women's Empowerment, the State Minister for Cooperatives and Small- and Medium-Scale Business, and UMK, BKKBN), UMKM associations (IWAPI, KADIN), Micro-Financial Development Movement and Research Institutions.

KKMB empowerment was aimed at empowering consultants/assistants, either private or those established by Government that had been involved in development of UMKM. Establishment of KKMB was based on a vision to expand access of productive business sectors to banking credits. It's mission would be to empower Financial Consultants/UMKM Assistants so that they would be able to provide services in business development and serve as an intermediary between UMKM and the banks. In performing their tasks, the taskforce formed a Technical Assistance Unit (UBT) that became the KKMB Empowerment Center and periodically reported on performance of its duties. Up to the end of 2003, KKMB taskforces had been established in six working areas of Bank Indonesia Branches (KBI), namely, KBI Banjarmasin, KBI Bandar Lampung, KBI Padang, KBI Solo, KBI Mataram, and KBI Balikpapan.

Development of Commercial Banks

From the **institutional** side, at end of reporting year, there were 138 commercial banks in operation (Table 8.1). The number declined from the previous year because three banks were closed and two private national banks were merged; one new foreign bank was set up. The closed banks were Agricole Indosuez, Societe Generale Indonesia Bank, and Merincorp Bank. The merged banks were Keppel Tat Lee Buana Bank and OCBC NISP Bank into OCBC Indonesia Bank. Meanwhile, a new foreign bank, Bank of China, opened and started operations in July 2003.

Out of the 138 banks, the Government holds ownership in 36 banks (26.1%), consisting of 5 state-owned banks, 2 ex-Takeover Banks (BTO), 3 recapitalized banks and 26 Regional Development Banks (BPDs). The remaining of 69 category-A bank and 2 ex-BTO which were already divested (51.4%) are owned by private domestic companies; 20 joints banks (14.5%) owned by national and foreign private companies; and 11 banks (8.0%) owned by foreign parties.

In general, **bank performance** in the reporting year was on a positive trend as shown by several major indicators (Table 8.2). Total credit and the LDR increased and the quality of credit was stable, indicating a continued recovery of bank intermediation. Further improvements were evidenced by the increase in capitalization and profitability. An important factor explaining these improvements was improving macro-economic indicators, such as interest rates, inflation and the exchange rate, supported by policies in bank restructuring and in sustained improvements in resilience of the banking system.

Table 8.1
Number of Banks and Bank Offices

Group of Banks	Outstanding			Growth (%)		Share[1] (%)
	2001	2002	2003	2002	2003	
I. Commercial Banks						
Number of Banks	145	141	138	-2.8	-2.1	100
Number of Offices (2)	6,765	7,001	7,730	3.5	10.4	100
State-owned Bank						
Number of Banks	5	5	5	0.0	0.0	3.6
Number of Offices (2)	1,807	1,885	2,072	4.3	9.9	26.8
Private National Forex Bank						
Number of Banks	38	36	36	-5.3	0.0	26.1
Number of Offices (2)	3,432	3,565	3,829	3.9	7.4	49.5
Private National Non-Forex Bank						
Number of Banks	42	40	40	-4.8	0.0	29.0
Number of Offices (2)	556	528	700	-5.0	32.6	10.0
Joint Banks						
Number of Banks	24	24	20	0.0	-16.7	14.5
Number of Offices (2)	53	53	57	0.0	7.5	0.8
Foreign Banks						
Number of Banks	10	10	11	0.0	10.0	8.0
Number of Offices (2)	60	61	69	1.7	13.1	1.0
Regional Development Banks						
Number of Banks	26	26	26	0.0	0.0	18.8
Number of Offices (2)	857	909	1,003	6.1	10.3	13.0
II. **Rural Credit Banks***	7,703	7,571	7,479	-1.7	-1.2	
Rural Credit Agencies	5,345	5,345	5,345	0.0	0.0	
Non Rural Credit Agencies	2,358	2,226	2,134	-5.6	-4.1	

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

Table 8.2
Commercial Bank Performance Indicators

(Trillions of Rp)

Indicators	1999	2000	2001	2002	2003*
Total Asset	1,006.7	1,030.5	1,099.7	1,112.2	1,142.2
Third Party Fund	617.6	699.1	797.4	835.8	875.4
Credit	277.3	320.4	358.6	410.3	475.7
LDR (%)	26.2	33.2	33.0	38.2	43.74
NPL - Gross (%)	32.8	18.8	12.1	8.1	8.1
NPL - Net (%)	7.3	5.8	3.6	2.1	1.8
Capital	(41.2)	53.5	62.3	93.0	105.9
CAR	(8.1)	12.5	20.5	22.5	20.7
Profit (Lost) before Tax	(75.4)	10.5	13.1	22.0	23.7
Net Interest Income	(38.6)	22.8	37.8	42.9	46.3

*) November

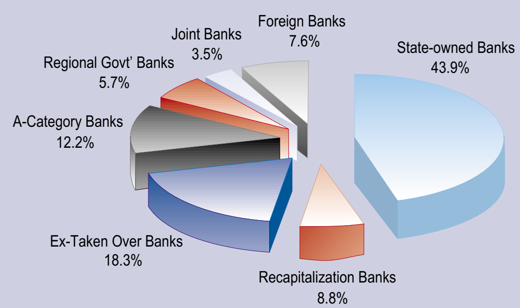


Chart 8.1
Assets by Group of Bank

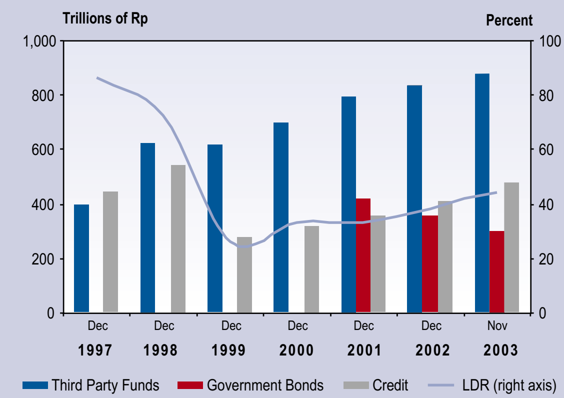


Chart 8.3
Third Party Funds, Credits and LDR

Total **bank assets** increased by 2.7% during 2003 as compare with last year, fueled by rising credits and holdings of SBIs. In terms of share of assets within the industry, the state-owned banks still predominated, followed by ex-BTO and Category A banks (Chart 8.1).

Viewed by composition, and consistent with the continued recovery of bank intermediation, the proportion of credits in earning assets increased from 40.1% in December 2002 to 44.7% at the end of the reporting year (Chart 8.2). By contrast, the portion of government bonds declined in line with the rising number of government bonds traded in secondary markets and the asset to bond swap program. These shifts in the composition of bank assets were indicative of progress in the recapitalization program, whereby banks have begun to use recapitalization bonds as a funding source for their business activities.

As regards **bank intermediation functions**, there has been a steady increase in third party funds, credits and LDR (Chart 8.3). An important cause was rising public confidence in banks as indicated by the confidence index survey. Nonetheless, there have been issues related to the slow growth of third party funds and credits.

Third party funds in the reporting year increased in comparison with the previous year, but at a slower pace.

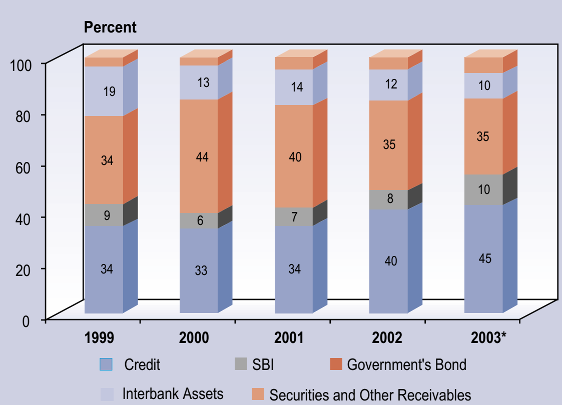


Chart 8.2
Composition of Earning Assets

Table 8.3
Composition of Deposits

Type of Deposits	Outstanding (Trillions of Rp)		Growth (%)		Share (%)	
	2002	2003[1)]	2002	2003[1)]	2002	2003[1)]
Demand Deposits	**197.0**	**211.9**	**5.8**	**7.5**	**23.6**	**24.2**
- Rupiah	130.2	141.8	8.5	8.9	66.1	66.9
- Foreign Currency	66.8	70.0	0.9	4.9	33.9	33.1
Time Deposits	**446.2**	**438.3**	**1.4**	**(1.8)**	**53.4**	**50.1**
- Rupiah	364.6	359.5	5.7	(1.4)	81.7	82.0
- Foreign Currency	81.6	78.7	(14.1)	(3.6)	18.3	18.0
Saving Deposits	**192.6**	**225.3**	**12.4**	**17.0**	**23.0**	**25.7**
Total	**835.8**	**875.4**	**4.8**	**4.7**	**100.0**	**100.0**
- Rupiah	687.4	726.7	8.1	5.7	82.2	83.0
- Foreign Currency	148.4	148.7	(8.0)	0.2	17.8	17.0

1) November

This slowdown was contributed by the decline in deposit interest capitalization in line with declining interest rates. Intense competition from other financial instruments, such as mutual funds (*Reksadana*; Table 8.16), held down the expansion of third party funds. The competition in fund mobilization is reflected in the sharp increase of mutual fund Net Assets Value (NAB). The type of products that experienced particularly rapid increases was fixed-income mutual funds (with recapitalization bonds as the key underlying assets). The transfer of banks' bonds into mutual fund followed by bank customers shifting their savings from bank deposits into mutual funds could result in third party fund statistics being understated .

Development of third party funds in the reporting period was also characterized by a shift in the composition of deposits from time into savings deposits (Table 8.3). This was partly due to the narrowing of the spread between the interest rates on deposit and savings accounts, that customers' preferences shifted into short-term savings. Viewed by type of third party funds, time deposits still predominated, representing 50.1% of the total, which was down from the end of 2002 (53.4%). By contrast, the

Table 8.4
Development in Bank Credit

Item	Outstanding (Trillions of Rupiah)			Growth (%)			Share (%)		
	2001	2002r	2003*	2001	2002r	2003*	2001	2002r	2003*
By Economic Sectors 1)									
- Agriculture	21.3	22.7	24.5	6.5	6.5	7.9	6.7	6.1	5.6
- Mining	3.1	3.9	5.1	(41.7)	27.3	30.8	1.0	1.1	1.2
- Industry	118.7	122.7	126.8	7.4	3.4	3.3	37.5	33.1	28.9
- Electricity, Water and Gas	5.1	4.4	4.7	(0.6)	(13.1)	6.0	1.6	1.2	1.1
- Construction	8.2	9.4	13.1	14.4	14.2	39.4	2.6	2.5	3.0
- Trade	49.3	66.3	83.5	6.7	34.5	25.9	15.6	17.9	19.1
- Transportation	7.6	12.4	15.1	3.6	63.1	21.8	2.4	3.3	3.4
- Business Services	27.7	31.8	48.0	4.7	14.6	50.8	8.8	8.6	10.9
- Social Services	3.6	4.6	11.0	20.8	29.4	139.1	1.1	1.2	2.5
- Other	71.5	92.9	106.4	37.6	29.9	14.5	22.6	25.0	24.3
Total	**316.0**	**371.1**	**438.1**	**11.7**	**17.4**	**18.1**	**100.0**	**100.0**	**100.0**
By Usage 1)									
- Working Capital	181.6	206.6	235.6	5.6	13.8	14.0	57.5	55.7	53.8
- Investment	75.8	84.4	97.6	10.5	11.3	15.6	24.0	22.8	22.3
- Consumption	58.6	80.0	105.0	39.0	36.5	31.2	18.5	21.6	24.0
Total	**316.1**	**371.1**	**438.1**	**11.7**	**17.4**	**18.1**	**100.0**	**100.0**	**100.0**
By Type of Bank									
- State-owned Bank	159.9	185.4	209.7	12.1	16.0	13.1	44.6	45.2	44.1
- Recapitalization Bank	27.7	21.3	43.2	(23.6)	(23.2)	102.8	7.7	5.2	9.1
- Former BTO	35.5	59.7	59.5	65.9	68.2	(0.3)	9.9	14.5	12.5
- A-Category Bank	44.7	59.1	70.1	38.0	32.3	18.6	12.5	14.4	14.7
- Regional Development Bank	17.1	23.3	31.4	48.5	36.6	34.8	4.8	5.7	6.6
- Joint Bank	29.2	25.1	25.3	(0.6)	(13.8)	0.7	8.1	6.1	5.3
- Foreign Bank	44.7	36.3	36.5	(4.7)	(18.7)	0.4	12.5	8.9	7.7
Total	**358.6**	**410.3**	**475.7**	**11.9**	**14.4**	**15.9**	**100.0**	**100.0**	**100.0**
By Currency									
- Rupiah	228.6	296.9	358.5	28.4	29.9	20.7	63.7	72.4	75.4
- Foreign Currency	130.1	113.4	117.2	(8.7)	(12.8)	3.3	36.3	27.6	24.6
Total	**358.6**	**410.3**	**475.7**	**11.9**	**14.4**	**15.9**	**100.0**	**100.0**	**100.0**

*) November
1) Excluding loans channeled through multifinance company

shares of demand deposits and savings accounts increased to 24.2% and 25.7% respectively.

Credit accelerated at little during the reporting year (Table 8.4). The nominal amount of credits outstanding at end-December 2003 reached Rp. 475.7 trillion, which is up by Rp. 65.4 trillion (15.9%). The comparable increase during 2002 was Rp. 51.7 trillion (14.4%). However, excluding the impact of exchange rate fluctuations (by measuring with a fixed exchange rate at the December 2000 level), the credit increase during 2003 was only about Rp. 69.0 trillion (17.8%), versus Rp. 69.5 trillion (21.9%) during 2002.

By business sector, the industrial sector still received the largest amount of credits in 2003, the same as last year. It was followed by trade, business services and agriculture. By utilization, credit shares were dominated by working capital, followed by consumer and investment credits. Last year, the share of investment credits exceeded that of consumer credits. By growth, consumer credits increased the fastest, followed by working capital and investment credits.

During the reporting year, the banks extended new credits in the amount of Rp. 55.9 trillion, Rp. 23.5 trillion (29.6%) less than in 2002 (Table 8.5). Factors accounting for this include: the on-going restructuring of the business sector; the growth of alternative financing instruments (such as corporate bonds); and the small decline in interest rates on credits compared with deposit rates.

By types of credit, working capital continued to make the largest contribution in extensions of new credits in 2003, followed by investment and consumer credits. Viewed by growth, working capital credits increased the most, followed by consumer and investment credits.

UMKM lending in the reporting year enjoyed an increase though at a slower rate than last year (Table 8.6). Through November 2003, the amount of funds extended was Rp. 25.8 trillion or equivalent to 60.8% of the total in business plans of banks in 2003. Viewed as a share in total credits, the shares of UMKM increased in 2003 relative to the previous year. This increase is expected to contribute to the quality of banks' assets because UMKM credits have lower gross NPL than other types of credits.

Table 8.5
Development in Realized New Credit

(Billions of Rp)

New Credit	2002	2003					Growth (%)	Share (%)
		Qtr I	Qtr II	Qtr III	Qtr IV*	Total		
By Economic Sectors								
- Agriculture	2,593	755	1,085	179	150	2,170	(16.3)	3.9
- Mining	1,392	70	130	42	106	348	(75.0)	0.6
- Industry	23,316	5,250	6,721	2,488	1,135	15,593	(33.1)	27.9
- Electricity, Water and Gas	325	1,039	127	4	2	1,172	260.9	2.1
- Construction	4,382	1,016	943	423	125	2,506	(42.8)	4.5
- Trade	16,621	4,672	5,508	2,557	805	13,542	(18.5)	24.2
- Transportation	7,022	603	1,196	232	150	2,181	(68.9)	3.9
- Business Services	10,701	1,615	3,248	672	469	6,004	(43.9)	10.7
- Social Services	586	152	217	147	68	584	(0.4)	1.0
- Others	12,478	3,130	4,373	3,277	1,022	11,802	(5.4)	21.1
Total	**79,416**	**18,301**	**23,547**	**10,022**	**4,031**	**55,901**	**(29.6)**	**100.0**
By Currency								
- Working Capital	50,276	8,776	14,042	5,800	2,502	31,120	(38.1)	55.7
- Investment	17,538	6,583	5,478	2,265	674	15,000	(14.5)	26.8
- Consumption	11,603	2,942	4,027	1,958	855	9,781	(15.7)	17.5
Total	**79,417**	**18,301**	**23,547**	**10,022**	**4,031**	**55,901**	**(29.6)**	**100.0**

* November

Table 8.6
Small, Medium and Micro Credit (Below Rp5 Billion)

(Trillions of Rp)

Item	2001	2002	2003*	Growth (%)		Share (%)	
				2002	2003	2002	2003
By Plafond							
1. Micro Credit (Rp 0 - 50 Million)	**59.5**	**83.2**	**101.5**	**39.9**	**21.9**	**100.0**	**100.0**
a. Working Capital	10.1	17.7	18.5	75.2	4.8	21.2	18.3
b. Investment	5.7	5.5	5.9	-3.8	7.6	6.5	5.8
c. Consumption	43.8	60.1	77.1	37.4	28.2	72.2	76.0
2. Small-Scale Credit (Rp 50 Million - 500 Million)	**28.5**	**39.4**	**50.2**	**38.4**	**27.4**	**100.0**	**100.0**
a. Working Capital	15.8	21.1	25.6	33.7	21.1	53.6	50.9
b. Investment	3.4	4.6	5.5	37.0	19.4	11.7	11.0
c. Consumption	9.3	13.7	19.1	46.7	39.8	34.7	38.1
3. Middle-Scale Credit (Rp 500 Million - 5 Billion)	**31.8**	**45.0**	**59.3**	**41.8**	**31.7**	**100.0**	**100.0**
a. Working Capital	24.4	35.0	44.0	43.2	25.9	77.6	74.2
b. Investment	5.6	7.3	10.4	31.0	42.6	16.2	17.5
c. Consumption	1.8	2.8	4.9	55.8	75.1	6.2	8.2
By Type							
1. Working Capital	50.3	73.7	88.1	46.6	19.5	44.0	41.8
2. Investment	14.6	17.3	21.8	18.8	25.5	10.3	10.3
3. Consumption	54.9	76.6	101.1	39.6	32.0	45.7	47.9
Total Small, Medium and Micro Credit	**119.7**	**167.7**	**210.9**	**40.0**	**25.8**	**100.0**	**100.0**

* November

The quality of **bank credit** remained stable in the reporting year. Although nominal NPLs rose from Rp. 33.2 trillion in December 2002 to Rp. 58.7 trillion at the end of 2003, banks' gross NPL ratio remained unchanged at 8.1%. Net NPLs improved from 2.1% into 1.8%. Increased credits accompanied by credit restructuring and formation of PPAP were the key factors in the stable NPL ratio in the reporting year.

On **profitability**, despite the continuous decline in interest rates during 2003, banks booked a wider net interest margin (NIM) than in the previous year. The decline in interest rates (for both SBIs and rupiah intervention) reduced banks' earnings from Variable Rate Bonds (VRB), which greatly affected overall bank earnings because of the importance of those instruments in total bank assets. On the other hand, new lending and relatively high interest

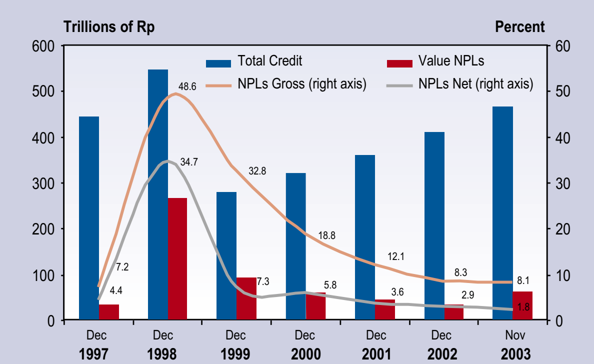


Chart 8.4
Non-Performing Loans

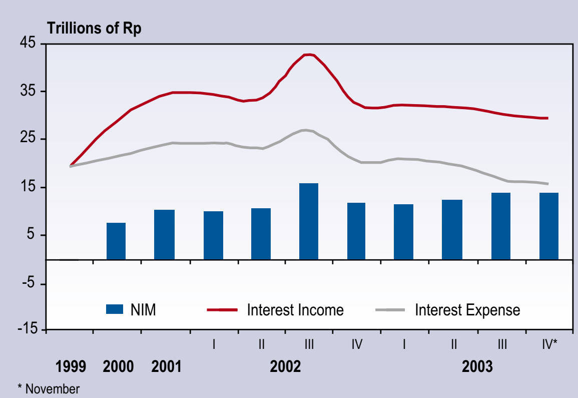


Chart 8.5
Net Interest Margin

rates on credits in the face of low rates on time deposits (a large component of the cost of fund) boosted earnings from credits. In line with the increasing NIM, profit earnings before tax also increased.

Improved bank performance boosted overall bank **capital** from Rp. 93.0 trillion in December 2002 to Rp. 105.9 trillion at the end of the reporting period. Such an increase originated from loss corrections to the previous year and profit earnings of the current year. Capital was most improved at the state-owned banks, followed by the ex-BTO banks and banks under Category A. Despite higher capital, the overall CAR dropped by 180 points to 20.7% compared to the end of 2002. All banks had a CAR above 8%.

Despite improved indicators of intermediation, noted earlier, intermediary activities of banks remained sub-optimal. This was reflected in large amounts of undisbursed credits (Chart 8.7) and a low LDR (Chart 8.3). From the external side, the major cause was similar to the factors causing the credit slowdown, namely, restructuring of the real sector and development of alternative financing sources (bonds). On the internal side, banks' perceptions of high risks and a wide spread between credit and deposit rates hampered the recovery of intermediation.

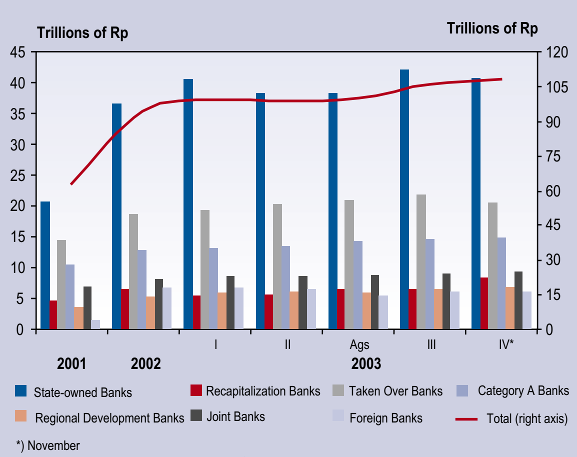


Chart 8.6
Bank's Capital

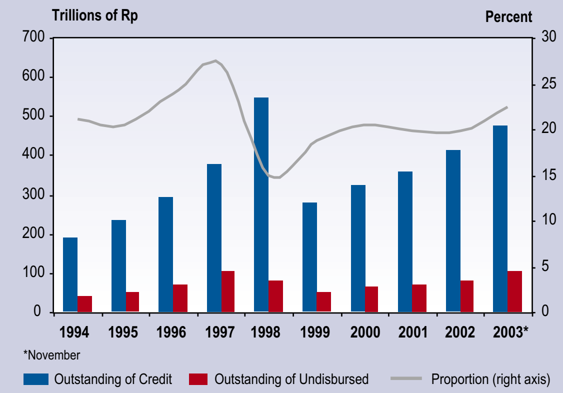


Chart 8.7
Undisbursed Credits

Development of Bank Perkreditan Rakyat (BPRs; Rural Banks)

Concerning **institutional** aspects, at the end of 2003 there were 2,123 active BPRs, of which 86 operated under sharia principles. This is down from the previous year as the licenses of 7 BPRs were revoked during 2003. Up to the reporting year, Bank Indonesia had revoked the licenses of 193 BPRs whose operations had been frozen (BBKU). By contrast, during the period of May 2001 through December 2003, there had been 92 applications for licenses to establish new BPRs.

From the side of **business operations**, the BPR industry in 2003 enjoyed stable growth as indicated by increases in total assets, funds collection and credit extensions (Table 8.7). As of end-June 2003, total assets of BPRs had increased by 11.9% from their position at end-2002.

Turning to **funds collection**, total savings and time deposits increased by 4.5% and 16.8% respectively, from the end of 2002 to the position at end-June 2003. Compared to the same period of the previous year, growth declined slightly.

Along with the increase in third party funds, lending activity (position as of June 2003) also increased, by 11.5%, which is slower than in 2003. This experience reflects the general slowdown in banking developments.

Table 8.7
Business Activities of Rural Credit Banks (BPR)

(Billions of Rp)

Item	2000	2001r	2002r	2003 1)
Volume of Business	4,731	6,748	9,344	10,461
Third Party Fund	3,082	4,295	6,145	6,927
Credit	3,619	5,039	6,864	7,656
Paid in Capital	705	936	1,094	1,167
Profit (Loss)	116	223	338	210

1) June

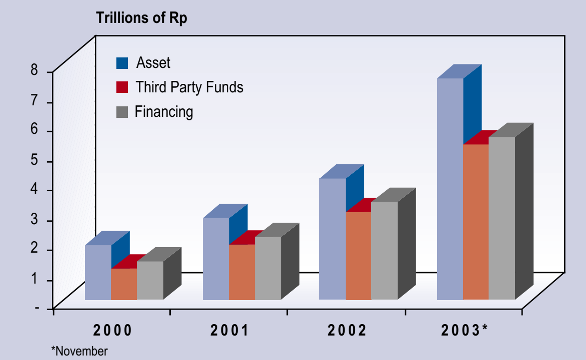


Chart 8.8
Business Activities of Sharia Banks

Sharia Banking Developments

From the **institutional** side, in the reporting year the number of sharia banks increased with the entry of two conventional commercial banks opening sharia business unit (UUS), i.e. BII and HSBC. HSBC is the first foreign bank to engage in sharia banking in Indonesia, indicating that the prospects for sharia banking in Indonesia are attractive to foreign investors. Meanwhile, in the reporting year operational licenses were granted to the three new sharia BPRs, i.e. Bumi Rinjani Batu, Bumi Rinjani Malang, and Cilegon Mandiri. However, in the same period two Sharia BPRs were closed, i.e. Bank Insani (Jakarta) and Artha Sakinah (Bandung). In total, the amount of sharia bank offices were more than doubled during 2003 (Table 8.8). The support of Bank Indonesia in the form of public education on sharia banking was an important factor in this expansion.

In line with an expanding network of offices, the assets of sharia banking industries also increased significantly, totaling Rp. 7.4 trillion by November 2003, up significantly (by 84.0%) from the previous year (Chart 8.7). This growth is the highest reached by sharia banks in the last three years. By the end of the reporting period, the proportion of sharia banks' total assets to those of national banks stood at 0.6% versus 0.4% at the end of 2002 (Table 8.9).

Funds collection by sharia banks also expanded rapidly, by 76.9%, during 2003 (Chart 8.8). All components grew significantly: current account by 52.3%; savings deposits by 75.8%; and deposits by 82.5%. Deposits continued to dominate third party fund as its share increased from about 59.8% at the end of 2002 to 61.6% at the end of the reporting year.

The growth of third party funds in the last several years indicated the enthusiasm of the public toward sharia banks. Their increasing number and widening of office network, coupled with improvements in services have become the driving forces behind such growth. In addition, extensive socialization, education, and promotion have

Table 8.8
Sharia Bank Offices Network

Item	1992	1999	2000	2001	2002	2003
BUS	1	2	2	2	2	2
UUS	0	1	3	3	6	8
Number of Office	1	40	62	96	127	255
Sharia Rural Credit Bank	9	78	78	81	83	84

Table 8.9
Share of Sharia Banking Activities to National Banking

(Percent)

Item	2000	2001	2002	2003 1)
Assets	0.17	0.25	0.36	0.61
Deposits	0.15	0.23	0.35	0.55
Financing	0.40	0.57	0.80	1.09

1) October

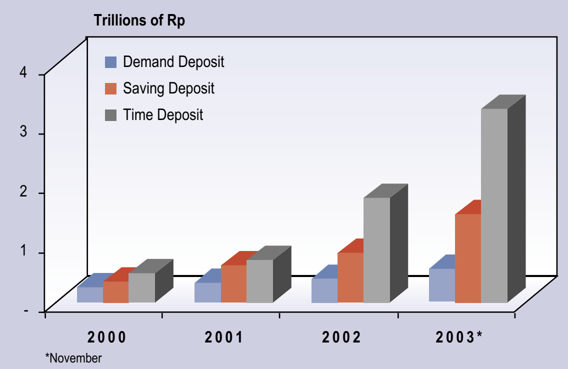


Chart 8.9
Development of Sharia Bank Financing

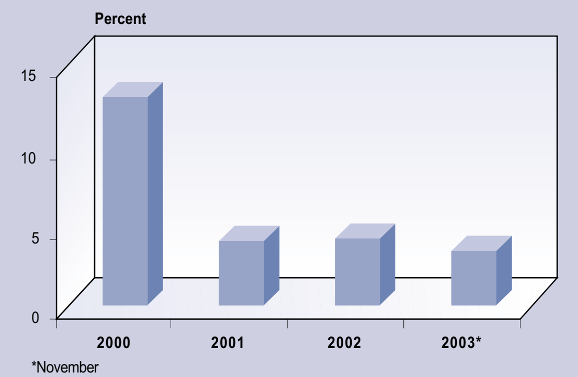


Chart 8.10
Sharia Bank Non-Performing Financing (Gross)

been carried out by Bank Indonesia, sharia banks and colleges/universities. Research findings done by Bank Indonesia in several regions point towards strong public preferences for sharia banks.[8]

On the assets side, **financing extended** during the reporting year grew by 66.8%, up from Rp. 3.3 trillion to Rp. 5.5 trillion. This growth was higher than that of Rp. 59.9% in the previous year. Sharia financing was still dominated by *murabahah* agreements, i.e. 71.2%, followed by *mudharabah* 15.1%, *istishna* 5.3% and *musyarakah* 5.3%.[9] Consistent with the increase in funds collections and financing, the Financing to Deposit Ratio (FDR) of sharia banks was well above the LDR level of conventional commercial banks, i.e. about 106% (by 2003). It indicated that intermediation of sharia banks took place without sacrificing the quality of earning assets as reflected on the Non-Performing Financing (NPF) ratio, which was still below 5%.

In general, capital adequacy of sharia banks has been quite good, although decreasing, in the last four years as the CAR remained above 8%. The declining CAR was caused primarily by rapid expansion of financing (Table 66.8%). If such a trend continues, the sharia banks will soon need to increase its paid up capital in order to maintain the CAR above 8%.

As for **profitability,** in the reporting year overall sharia banks recorded profits of about Rp. 48.5 billion with an average Return on Assets (ROA) of 0.65%. This relatively low ROA was due to the existence of new UUS that had not yet generated profits.

On the sharia financial market side, instruments currently available covered W*adiah* Certificate of Bank Indonesia (SWBI), Interbank Money Market based on Sharia Principles (PUAS), and sharia bonds. SWBI position at the end of 2003 was recorded at about Rp. 1.623 trillion. The average monthly SWBI position was Rp. 911 billion and tended to increase during 2003. Meanwhile, PUAS activities fluctuated with the highest volume in June 2003 of about Rp. 26 billion.

Table 8.10
Sharia Bank CAR and ROA Development

(Percent)

Item	2000	2001	2002	2003[1)]
CAR: BUS	53.4	30.8	21.5	20.3
CAR: UUS	23.7	19.9	36.5	32.8
ROA		1.2	0.8	0.6

1) November

8 Results of those research are available at Bank Indonesia's website
9 **Murabahah** is a sales contract between a bank and its customers. The Bank purchases goods ordered by the customer. The customer has to pay the original price plus a certain profit agreed upon.
Mudharabah is a contract between the capital owner and the management pertaining to profit or revenue sharing.
Istishna is a sales contract between buyer and seller. Specs and prices are set intially along with installment upon mutual agreement. In case the bank acts as the seller and refers the other party to produce the good, this is called Paralel Istishna.
Musyarakah is a consortium to finance a business unit. Revenue or profit will be distributed to each party based on share agreed upon.

The issuance of rules by the National Sharia Board on Sharia Bonds in September 2002, has allowed the Indonesian sharia banks to gain alternative financing for their operational activities. Issuance of sharia bonds constitutes long-term financing that can be classified into sub-ordinated loans. Sharia banks that have issued these sharia bonds were, *inter alia*, Bank Bukopin (Sharia Business Unit), Bank Muamalat Indonesia (BMI) and Bank Sharia Mandiri (BSM). Bank Bukopin's sharia business unit was the first to obtain license from Bank Indonesia to issue sharia bonds, which amounted to about Rp. 100 billion with a five-year tenor. Meanwhile, BMI and BSM issued sharia bonds each in the amounts of Rp. 200 billion in 2003.

OTHER FINANCIAL INSTITUTIONS

In 2003, non-bank financial institutions (such as finance companies, state-owned pawn shops, and mutual funds (*Reksadana*) generally enjoyed an increase in their total assets, value of their business services and their profits. Slow progress in bank intermediation opened opportunities for non-bank financial institutions to develop. As an alternative financing source, financing companies and pawnshops were highly used by the public and small- and medium-scale enterprises. As an investment facility, mutual funds provided higher yields than savings accounts at banks.

Multi-Finance

The **performance** of multi-finance companies improved significantly in 2003 (Table 8.11). Better performance was reflected in rising total assets, the value of business services and current year profits. During 2003, total assets of financing companies increased by 18.2%, while the value of business services increased by 22.6% with current year profits of about Rp. 2.1 trillion. In the last two years, finance companies have recorded profits after continued losses in previous years.

Table 8.11
Development of Multifinance Companies Performance

Item	Outstanding (Trillions of Rp)			Share (%)	
	2001	2002r	2003*	2002r	2003*
Number of Companies [1]	246	247	212	0.4	-14.2
Total Assets	37.3	39.9	47.2	7.0	18.2
Business Value	30.8	32.9	40.4	6.8	22.6
Leasing	14.1	12.6	13.6	-11.0	8.3
Factoring	3.3	3.2	3.2	-2.9	0.2
Credit Card	0.8	1.1	0.8	44.1	-29.3
Consumer Finance	12.4	15.6	22.7	26.2	45.4
Others	0.3	0.4	0.1	57.9	-82.0
Borrowings [2]	31.1	28.4	29.3	-8.8	3.1
Domestic	18.4	16.9	15.9	-7.9	-6.3
Foreign	12.8	11.5	13.4	-10.2	16.8
Bonds	0.7	1.7	4.0	123.9	138.5
Paid in Capital	6.8	7.6	8.8	13.0	14.6
Profit (Loss)	(0.1)	1.8	2.1	-	-

1) Unit
2) Incl. Subordinated Loan

Viewed by type of business operations, consumer lending dominated with market share of 56.2% (Table 8.11). Up to 2001, leasing business had always dominated the business services of multi-finance companies. This increase in consumer lending had been in line with the upward trend in domestic consumption growth of the last several years.

Table 8.12
Sources and Uses of Fund by Multifinance Companies

Item	Outstanding (Trillions of Rp)			Growth (%)	
	2001	2002r	2003*	2002r	2003*
Sources of Fund	**37.3**	**39.9**	**47.2**	**7.0**	**18.2**
Bank Borrowings	21.1	18.8	21.6	-11.1	14.6
- Domestic	14.2	13.2	14.7	-7.1	11.2
- Foreign	7.0	5.6	6.9	-19.2	22.6
Other Borrowings [1]	10.0	9.6	7.7	-4.0	-19.7
- Domestic	4.2	3.7	1.2	-10.4	-68.1
- Foreign	5.8	5.9	6.5	0.5	11.2
Bonds	0.7	1.7	4.0	123.9	138.5
Capital [2]	(0.6)	1.8	4.5	415.3	151.1
Others	6.0	8.1	9.5	34.5	17.3
Uses of Funds	**37.3**	**39.9**	**47.2**	**7.0**	**18.2**
Financing	30.8	32.9	40.4	6.8	22.7
Bank deposits	3.0	3.1	2.5	4.5	-19.3
Equity Participation	0.1	0.1	0.1	-2.7	1.3
Others	3.4	3.8	4.2	11.0	11.1

1) Incl. Subordinated loan
2) Net capital after compensated by current year profit/loss retained earnings, and provisions.

Table 8.13
Financing by Economic Sector

Economic Sectors	Financing (Trillions of Rp)			Share (%)		Growth (%)	
	2001	2002r	2003*	2002r	2003*	2002r	2003*
Agriculture	0.6	0.5	0.5	1.6	1.2	-8.8	-15.7
Mining	0.4	0.6	0.9	1.8	2.3	44.8	46.0
Industry	6.1	4.9	4.5	14.3	11.5	-20.4	-7.4
Electricity, Water and Gas	0.1	0.1	0.1	0.2	0.2	-52.7	16.5
Construction	2.0	1.6	1.5	4.8	3.9	-17.7	-6.6
Trade	4.4	4.6	5.1	13.7	12.9	6.1	8.9
Transportation	2.4	2.6	1.7	7.7	4.4	9.0	-34.3
Business Services	0.9	0.9	1.1	2.6	2.7	-4.0	20.7
Social Services	0.6	1.1	1.4	3.1	3.5	64.0	31.1
Others	13.3	17.0	22.5	50.2	57.5	28.2	32.1
Total	**30.8**	**33.9**	**39.2**	**100.0**	**100.0**	**10.0**	**15.4**

During 2003, total funding increased in comparison to the previous year (Table 8.12). The funding sources included bonds, paid-up capital and bank loans, with the greatest expansion in bonds. This indicates a healthy diversification in sources of financing away from banking.

In the reporting period, there was no major change in the utilization of funds extended by the multi-finance companies, as most funds were channeled in the form of financing business activities. In line with overall economic improvement, financing services in the reporting year also grew more rapidly than in the previous year, thereby boosting financing companies' revenues. The current year's profit plus increases in paid-up capital boosted net capital in the reporting year to Rp. 4.5 trillion.

Table 8.14
Quality of Earning Assets of Multifinance Companies

(Percent)

Productive Assets	2001			2002			2003*		
	C	D	L	C	D	L	C	D	L
Financing :	**78,0**	**5,3**	**16,7**	**82,2**	**4,2**	**13,6**	**89,6**	**2,1**	**8,3**
- Leasing	76,5	7,8	15,7	79,1	4,5	16,3	87,9	2,8	9,3
- Factoring	28,9	6,4	64,7	29,8	6,2	64,0	40,7	6,6	52,8
- Credit Card	75,7	2,3	22,0	93,9	3,7	2,4	91,2	5,1	3,7
- Consumer Financing	96,3	1,7	2,1	97,1	1,5	1,4	98,0	0,9	1,1
Securities	**85,3**	**6,1**	**8,6**	**83,2**	**3,6**	**13,2**	**92,6**	**0,5**	**6,9**
Equity	**93,1**	**0,2**	**6,8**	**96,5**	**3,4**	**0,1**	**97,3**	**2,7**	**-**
Total Earning Assets	**78,4**	**5,3**	**16,3**	**82,4**	**3,4**	**14,2**	**89,6**	**2,1**	**8,3**

C = Current, D = Doubtfull, L = Loss

Considering lending by sector (Table 8.13), the largest contribution in the reporting year came from trade. Previously, the largest sector had been industry, but these continued to decrease in 2003. Other sectors enjoying significant financing were transportation and construction.

By collectability, there were improvement in the quality of the financing companies' earning assets, which consisted of financing services (leasing, factoring, credit cards and consumer financing), commercial paper and equity investment. There was an increase in the percentage of performing earning assets, whereas the percentage of non-performing earning assets decreased. This upward trend is common to the last two reporting periods.

State-owned Pawn Company

The performance of state-owned pawn company also improved during 2003 compared to the previous years (Chart 8.11). Such an increase was indicated by all performance indicators of the state-owned pawn companies, including total assets, loans granted, operating income and current year's profit. Up to the end of 2003, credit extended by state-owned pawn offices reached Rp. 8.8 trillion. up 12.6% compared to the previous year, leading to improved operational income and current year's

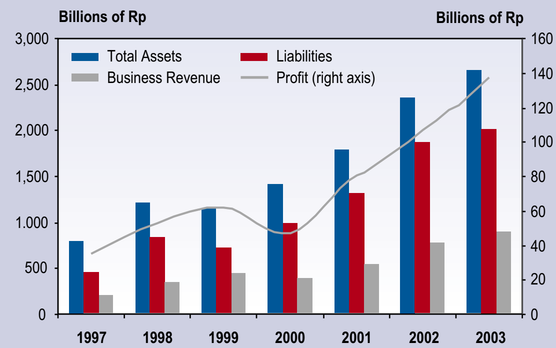


Chart 8.11
Performance of State-owned Pawn Companies

Table 8.15
Performance of State-owned Pawn Companies

(Millions of Rp)

Item	2000	2001	2002r	2003*
Total Branch Offices 1)	659	706	739	774
Credit Extended	4.230.778	5.970.310	7.823.704	8.810.307
Operational Income	377.162	552.358	818.057	951.241
- Capital Leasing	341.936	500.562	737.998	867.813
- Custody & Insurance	31.270	47.033	71.652	69.763
- Others	3.956	4.763	8.407	13.665
Liabilities Outstanding				
- Short-term Liabilities	454.176	480.568	932.806	794.703
a. Bank Loans	157.631	252.363	631.976	451.532
b. Promissary Notes	50.000	50.000	130.000	132.000
c. Bonds Due	199.710	99.750	63.928	95.000
d. Others	46.835	78.455	106.902	116.171
- Bonds	439.486	636.672	856.426	1.241.539
- Long Terms Liabilities	105.000	200.000	95.000	-
- Equity	415.256	475.614	543.066	624.954
Profit/Loss	46.838	80.851	107.867	140.201
Number of Customers 2)	12.982.306	15.692.229	12.078.000	14.318.000

* Based on Consolidated Financial Report 2003
1) Units
2) Persons

profits. In general, further improvement could still be achieved through expansion in services and product diversification.

In extending wider services to the public, the state-owned pawn company expanded their branch network (Table 8.15). During 2003, there were 34 new branches and one new regional branch, the former scattered all over Indonesia. This brought the total number of branches of the state-owned pawn company to 774 by the end of the reporting year. Such expansion in service network was followed by an increase in the number of customers, despite tougher competition with other financial institutions. The total number of customers successfully served by the state-owned pawn offices in the reporting year increased by 18.6%. By composition, most customers of the state-owned pawn company were farmers, followed by merchants and small-scale industries.

Out of the total number of new branches opened during the reporting period, five were sharia-based pawn offices spread over five regional branches and two branches that served *Unhulled Paddy Sales Deferred Credit (Kredit Tunda Jual Gabah).* Products of unhulled paddy and sharia pawn products were a breakthrough of the state-owned pawn company that gave benefits to farmers, helping them to avoid the trap of profiteers. In their operations, pawn offices cooperated with agents as well as KUD (Rural Cooperatives) as operators. Since its launching last year, both products received positive responses from the public, as seen in the total number of customers that reached 13,702.

The office expansion strategy and product diversification also succeeded in improving business proceeds (credits extended) of the state-owned pawn offices. Higher credits significantly boosted earnings, by 16.3%. The largest contribution was provided by their main service, namely capital leases, followed by storage and insurance. Improvement in earnings and various efficiency efforts made by the state-owned pawn company successfully increased profit in the current year. During 2003, the public pawnshop services recorded profits of about Rp. 107.9 billion, an increased of 29.9% compared to that in the previous year.

From the side of fund sources, issuance of bonds became the main source in the reporting year, rising by 44.9%. Based on various improved performance indicators of the state-owned pawn company, in the reporting year Pefindo rated bonds issued by the state-owned pawn company as AA (stable outlook). Loans from banks were relatively stable. Other funding sources included equity, short-term non-bank loans and long-term loans.

Mutual Funds (Reksadana)

The development of Indonesian financial markets in 2003 was marked by rapid expansion of mutual funds (*Reksadana*), especially as an alternative financial market investment.

The most attractive product of mutual funds was government bond-based fixed income mutual funds. The development of mutual funds in Indonesia was associated with several factors such as (i) increasing intensity in issuance as well as trading of government bonds in secondary markets; (ii) declining bank interest rates; and (iii) privilege in the form of income tax relief from withholding taxes (Government Regulations No.6/2002). Low bank interest rates and this tax relief had made the return offered by mutual funds very attractive to consumers.

In relation to the banking sector, significant redemptions in October 2003 reminded us of the need for tight prudential rules on banks engaging in any business with mutual funds. The redemptions in October were fueled by issues surrounding a change in the "marked to market" method for the net assets value of mutual funds. As a result, there was a significant decrease of nest assets value from Rp. 85.9 trillion (September 2003) to Rp. 69.5 trillion at the end of 2003. To anticipate problems that might harm the banking sector, Bank Indonesia issued Circulars appealing to banks to follow prudent principles in doing business with mutual funds. Such restrictions are expected to minimize the risks that would trigger systemic problems in the banking sector.

Table 8.16
Development of Mutual Funds

(Millions of Rp)

	Stock	Mix	Money Market	Fixed Income	Total
1996	519.3	349.6	15.6	1,897.9	**2,782.3**
1997	590.4	862.4	25.4	3,438.5	**4,916.6**
1998	539.0	521.5	37.7	1,894.0	**2,992.2**
1999	926.5	728.7	575.2	2,743.7	**4,974.1**
2000	560.4	649.9	1,243.6	3,062.0	**5,516.0**
2001	490.9	635.3	2,217.1	4,660.5	**8,003.8**
2002	302.3	1,794.9	7,180.6	37,336.1	**46,613.8**
2003	402.3	3,734.4	7,856.2	57,484.9	**69,477.7**

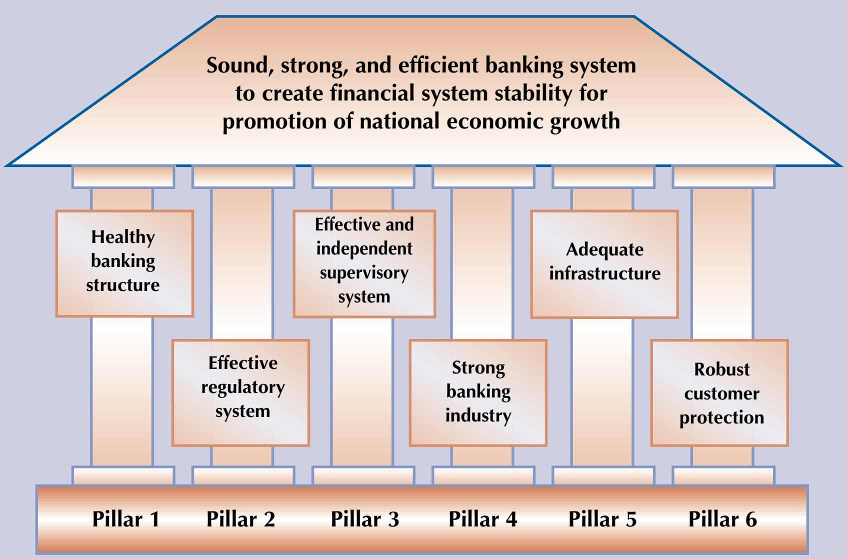
Box The Indonesian Banking Architecture: Strategy to Establish a Sound Banking Industry

Over the past two years, Bank Indonesia has completed a blueprint of the Indonesian Banking Architecture (Arsitektur Perbankan Indonesia/API) based on valuable inputs from stakeholders. On January 9, 2004, the Governor of Bank Indonesia announced that the banking architecture will be implemented, starting in 2004 through the next ten years.

The Indonesian Banking Architecture constitutes a policy reference point for banking industry development, covering the banking structure and long term direction of the banking industry. This program is a follow up to the ongoing banking restructuring program begun in 1998. Several countries such as Singapore, Hong Kong, Canada, and Australia, have established a blueprint resembling API. Through this blueprint, the national banking system is expected to undertake all necessary measures throughout the next ten years in order to strengthen the fundamentals of the banking industry. Additionally this blueprint is expected to enable banks to withstand internal and external shocks.

To realize the Architecture's vision of a sound, strong and efficient domestic banking system capable of maintaining financial stability as well as promoting sustainable economic development, a number of objectives have been established. Those objectives are represented by the six pillars of the Indonesian Banking Architectures. Each pillar is an important element related to banking operations as depicted in diagram 1.

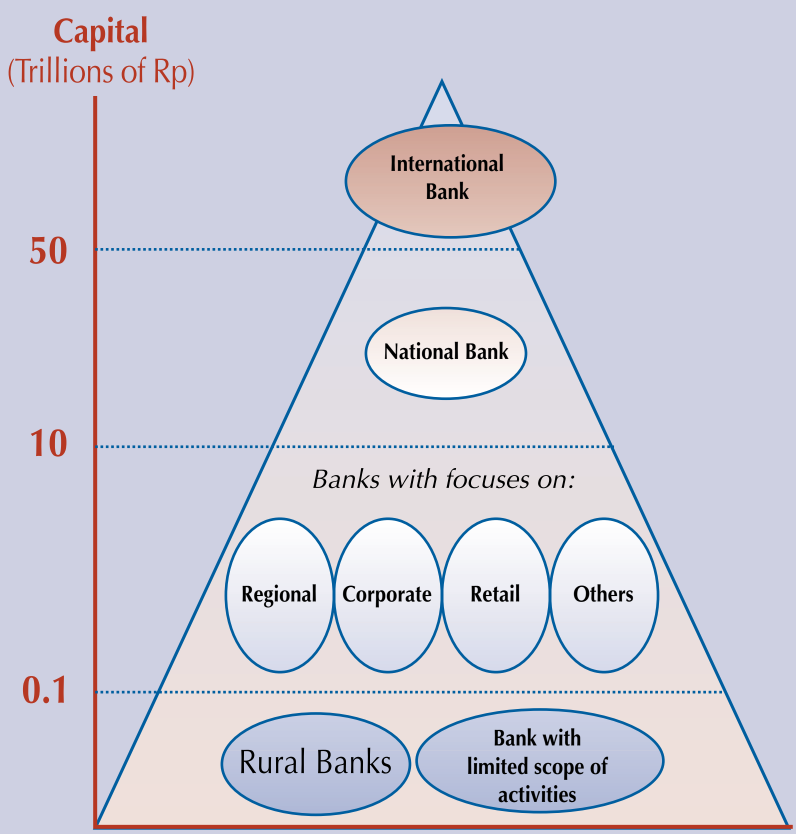
Diagram 1
Indonesian Banking Architecture Framework



Additionally, API provides a clear direction towards an optimum banking structure in the next ten to fifteen years. This long term structure could be envisaged such as, two or three banks emerging as international banks (international champions) possessing the capacity and ability to operate on an international scale, accompanied by 3 to 5 national banks (national champions) with a broad scope of business and operating nationwide. To complement the above structure, 30 to 50 banks are expected to operate as focused players, with operations limited to particular business activities, business segments and regions (such as retail bank, corporate bank, haj-pilgrimage bank, agricultural bank and local banks), according to their capability and competence. Finally, the existence of rural banks and banks with limited scope of business will finalize the structure.

To carry out the above grand design, API has several programs that are clustered into 19 initiatives with the following timetable:

Diagram 2
Banking Vision



I. Program on reinforcing the structure of the national banking system

1. Strengthening of bank capital
   - a. Increase minimum capital requirement for commercial banks (including regional development banks) to Rp100 billion (2004-2010)
   - b. Retain Rp3 trillion capital requirement for establishment of new banks through January 1, 2011 (2004-2010)
2. Increase competitiveness of rural banks
   - a. Strengthen linkage programs between commercial banks and rural banks (2004)
   - b. Simplify processes for opening of rural bank branch offices (2004)
   - c. Facilitate establishment of joint services facilities for rural banks (2004)
3. Improve access to credit
   - a. Facilitate establishment of a credit guarantee scheme (2004-2006)
   - b. Promote lending to specific business sectors (2004-2006)

II. Program on Improving the Quality of Bank Regulation

1. Formalize syndication process in formulation of banking policy
   - a. Involve third parties in formulation of banking policy (2004)
   - b. Establish panel of banking experts (2004)
   - c. Facilitate establishment of banking research institutions at regional and central levels (2004)
2. Phased implementation of 25 Basel Core Principles for Effective Banking Supervision (2004-2013)

III. Program on Improving Bank Supervisory Function

1. Enhance coordination among supervisory agencies through regular coordination and cooperation (2004)
2. Consolidate the banking supervision sector at Bank Indonesia
   - a. Consolidate the supervision and examination functions (2004-2005)
   - b. Reorganize the banking sector at Bank Indonesia (2004-2005)
   - c. Establish an enforcement team (2004-2005)
   - d. Establish a specialist examination team (2004-2005)
3. Improve competency of bank examiners
   - a. Introduce certification of bank examiners (2004-2005)
   - b. Conduct examiners attachment programs at international supervisory agencies (2004-2005)
4. Develop system for risk-based supervision, initiated by designing a risk-based model for supervision (2004-2005)
5. Improve effectiveness of enforcement
   - a. Strengthen investigation processes for banking crimes (2004-2005)
   - b. Improve transparency of supervision and enforcement (2004-2005)
   - c. Establish internal ombudsman for supervisory problems (2004-2005)
   - d. Improve legal protection for bank supervisors (2004-2005)

IV. Quality Improvement Program for Bank Management and Operations

1. Strengthen Good Corporate Governance

   a. Establish minimum standards for Good Corporate Governance (2004-2005)
   b. Encourage banks to go public (2004-2005)
2. Improve quality of bank risk management by introducing compulsory certification of risk managers (2005)
3. Improve bank operating capabilities
   a. Encourage banks to develop shared use of operating facilities to reduce costs (2004-2005)
   b. Facilitate provision of education needed for improvement of banking operations (2004-2005)

V. **Program for Development of Banking Infrastructure**

1. Development of Credit Bureau by initiating the establishment of credit bureau (2004-2005)
2. Optimize use of credit rating agencies by instituting compulsory rating for bonds issued by banks (2004-2005)

VI. **Program for Improvement of Customer Protection**

1. Prepare standards for customer complaint mechanism, *inter alia*, by establishing minimum requirements for consumer complaints mechanism (2004-2005)
2. Facilitate establishment of a banking mediation agency (2004-2005)
3. Design transparency of product information, by facilitating preparation of minimum standards of transparency in bank product information (2004-2005)
4. Promote consumer education, encouraging banks to educate consumers on financial products (2004)

Box International Conference on Sharia Banking

During the period September 30-October 20, 2003, Bank Indonesia, in cooperation with the Ministry of Finance and the Islamic Research and Training Institute – Islamic Development Bank (IRTI-IDB) conducted an International Conference on Islamic Banking: Risk Management, Regulation Supervision under the theme of "Towards International Regulatory Convergence". This conference was aimed at providing an international forum to address thoughts and discussions over sharia banking's relevance in the context of creating financial system stability, understanding distinctive characteristics of sharia banking business risks, and the sharia banking supervisory system.

The forum was attended by 26 experts from various international institutions, such as the ADB, the IMF, the World Bank, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the International Islamic Financial Market (IIIFM) and the International Islamic Rating Agency (IIRA), central banks, International Sharia Banking communities and academics. Outcomes from the conference included:

COMPLIANCE WITH SHARIA PRINCIPLES

Standardized sharia principles contained in instruments and products of Sharia banking are one of the crucial issues to be promptly implemented. Formulation of standardized sharia principles is highly required in the development of a sound and stable financial system, both by institution and for the entire banking system. This standard would sustain synchronization and integration of sharia financial system, thus, enhancing the development of the industry.

To be effective, the establishment of a Sharia Board is indispensable to a sharia banking institution. For example, differing opinions over the validity of sharia financial contracts remain a challenge. Therefore, every stakeholder within the sharia industry must share in a spirit of cohesion to solve the existing problems.

OPERATIONAL EFFICIENCY

Generally, sharia banking has achieved an adequate level of efficiency. To upgrade efficiency further, several issues were suggested on the conference. First, the significance of a comprehensive understanding of modern banking management that could be applied in sharia banking practice. Second, the importance of internationally standardized rules within the sharia banking industry. In this case, the existence of International Sharia Institutions such as IIRA, AAOIFI, IIFM, and IFSB are expected to support the creation of a competitive, effective and efficient sharia banking industry.

PRUDENTIAL REGULATION

Considering sharia banking's unique characteristics, regulatory institutions are required to have such appropriate rules. These rules are expected to strongly contribute to the creation of prudential banking operations, consistent fulfillment of sharia principles without losing its unique characteristics and advantages. As regards to its unique characteristics, the sharia banking regulatory framework should impose higher disclosure; proper licensing mechanisms during selection of its personnel and business activities; and effective supervision resembling conventional banks along with supervision on compliance aspects of sharia principals. Furthermore, to complement the regulatory infrastructure of the authorities, market discipline constitutes an important factor in creating a sound sharia banking industry. Sharia banking also requires adjustment towards international best practice, in particular, the New Basle Accord is widely accepted as a standard for international banking practices.

SYSTEMIC STABILITY

Maintaining stability of a system remains the most important objective within the international financial system. The importance of systemic stability prompted widespread re-thinking of the entire system, known as the financial architecture, covering infrastructure and supporting institutions. To maintain sharia financial system stability, it is important to have effective risk-based management, supported by sufficient financial infrastructure as well as a design of instruments that is legally sound and clear. Therefore, achieving financial system stability is largely determined by the performance of two market participants, i.e., sharia financial industry players and the regulatory authorities.

Chapter 9: National Payment System

Chapter 9: National Payment System

Efforts to develop an efficient, fast, safe, and reliable national payment system shown various significant progress. In the area of cash payment system, policies were focused on satisfying the demand for currency, keeping the quality of the currency in circulation, and taking preventive and repressive measures against counterfeiting. In the area of non-cash payment system, policies were focused on reducing risks through, among others, extending BI-RTGS (Bank Indonesia - Real Time Gross Settlement) network in all branch offices of Bank Indonesia and improving the efficiency of payment system.

In order to achieve and maintain the stability of rupiah value, one of the main responsibilities of Bank Indonesia is to develop an efficient, fast, safe, and reliable national payment system. For this purpose, Bank Indonesia in 2003 has issued various policies in payment system sector. **In the area of cash payment system**, the policies covered three principal aspects, including fulfilling public needs for currency, ensuring that bank notes were fit for circulation, and taking preventive and repressive measures against the circulation of counterfeit currency. **In the area of non-cash payment system**, the policies were focused on reducing risks and improving efficiency of payment system.

In general, payment system activities in 2003 experienced an improvement in line with the increasing public needs for both cash and non-cash payment instruments. However, currency in circulation (UYD) showed a slight decline compared to that in the previous year. This was in line with the decline in demand for currency for precautionary motive. In the meantime, along with the wider implementation of the BI-RTGS system, non-cash payment activity through the BI-RTGS system rose, while clearing transaction declined. Card-based payment instruments such as credit cards, debit cards, and Automatic Teller Machine (ATM) cards showed an increase due to, among others, the expansion of ATM network.

PAYMENT SYSTEM POLICY IN 2003

Cash Payment System

In order to fulfill the public needs for currency, the policy was still mainly directed at the timely provision of currency in fit-for-circulation condition and sufficient amount, both in nominal value and by denomination. As to nominal amount, Bank Indonesia made efforts to satisfy public needs for currency that continued to increase, particularly on the event of religious celebration and New Year holidays. Furthermore, in order to satisfy demand of small denomination, a pilot project developed in cooperation with third parties in the distribution of small denominations in Jabotabek (Jakarta, Bogor, Tangerang, and Bekasi) regions in the reporting year had its regional coverage be extended to 7 BI's branch offices, namely, Medan, Palembang, Bandung, Semarang, Surabaya, Denpasar, and Makassar. Through such exchange cooperation, the public could exchange small denominations they needed from money-exchange places operated by third parties free of charge.

In addition, in order to obtain metal materials for coins, with intrinsic value lower than its nominal value and with relatively longer circulation life, a study on alternative compositions in the metal content of rupiah coins and standardized size of coins was made in 2003. Based on this study, new emission of coins, namely, Rp200 and Rp500 coins were issued in 2003 using aluminum material.

With respect to counterfeiting of rupiah, Bank Indonesia has continually increased its efforts to cope with it both on preventive and repressive manners. Preventive measures currently taken are improving currency design and increasing the use of security features for the issuance of new emission of banknotes in Rp50,000, Rp20,000, and Rp10,000 denominations. Furthermore, a study on the possibility of replacing the banknotes of Rp100,000 with plastic polymer material was conducted. Increasing such security element is aimed at facilitating the public in differentiating counterfeit from genuine currency, both with plain view and touch.

Other preventive measures involve dissemination of information on the characteristics of genuine rupiah and the simple way to differentiate counterfeit from authentic rupiah currency through distribution of pamphlets and seminars to students, public figures, businessmen, and cashiers. Efforts have also been made through increased coordination with related parties incorporated in the National Coordinating Board for Counterfeiting and Forgeries Eradication (BOTASUPAL). Meanwhile, repressive measure was taken in coordination with relevant bureaus by arresting those involved in counterfeiting and bringing them to court.

Non-Cash Payment System

In 2003, policies in non-cash payment system were aimed at reducing payment risks and improving efficiency of payment system. To limit risks in payment system, Bank Indonesia completed the implementation of BI-RTGS system in all of its branch offices and to improve its legal aspects, to draft the Bill on Fund Transfer, as well as to formulate "Failure to Settle Arrangement". In the meantime, in order to be able to improve efficiency in payment system, a paperless credit note was developed.

Implementation of BI-RTGS

Implementation of BI-RTGS system that has commenced in November 2000 and has been implemented in all banks and BI's branch offices since June 2003 was one of the efforts to reduce risks in payment system. BI-RTGS system is expected to be capable of reducing possible risks in payment system. With BI-RTGS system, risks embedded in the settlement process can be minimized as transactions cannot be executed unless there is sufficient amount in the bank's account with Bank Indonesia (no money no game).

Since the implementation of BI-RTGS system, there has been a shift from settlement of transactions through clearing system to that using BI-RTGS system (Chart 9.11). With the implementation of BI-RTGS system in all banks and BI's branch offices, the risks in payment system can be minimized since it is no longer accumulated at the end of the day (multilateral netting clearing system) but instead spread along the operational hours of the BI-RTGS system.

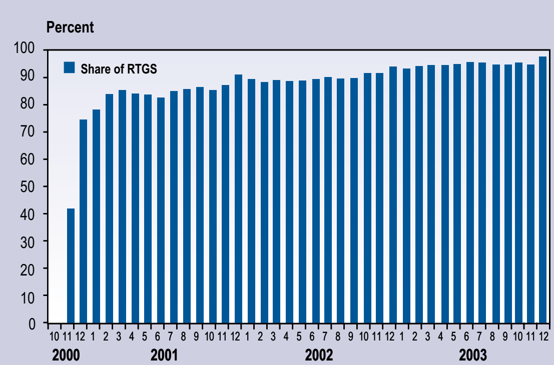


Chart 9.1
Use of Clearing System vs RTGS System

This condition stimulates good liquidity management by banks. In December 2003 the percentage use of BI-RTGS system reached 94.8%, whereas that of clearing system was 5.2%.

Drafting the Bill on Fund Transfer

The formulation of the Bill on Fund Transfer is aimed at reducing legal risks in payment system. Furthermore, it is in accordance with point 1 of Core Principle Systematically Important Payment System (CP-SIPS), which states that payment system shall have a strong legal foundation. In order to reduce legal risks and to fulfill the CP-SIPS, in 2003 Bank Indonesia started the preparation of the Bill on Fund Transfer *(Box: Drafting of Fund Transfer Bill: BI's 2003 Special Project*). This regulation is one of the efforts to give legal certainty and protection for those involved in fund transfer activity (bank and non-bank institution) taking into account that fund transfer is currently still conducted based on internal rules of respective organizer of such transfer.

Formulation of Failure to Settle Arrangement

The current clearing system prompts banks to carry out final settlement at the end of the day (net settlement) resulting in accumulated liquidity at the end of the day thus risking bank's debit balance. To maintain a smooth payment, Bank Indonesia has so far been responsible for covering any lack of fund suffered by banks failing to settle their clearings. By referring to CP-SIPS, Bank Indonesia will implement a mechanism that would prevent Bank Indonesia from being liable for banks' insufficient fund in settling their clearings without interrupting the clearing settlement. Such mechanism is known as failure to settle arrangement, for which by the end of 2003 socialization and discussions on such mechanism has been carried out by Bank Indonesia together with the National Payment System Communication Forum.

Development of Paperless Credit Note (PNK)

Within the clearing system, inter-bank credit transfer process, both for banks and bank customers has so far adopted a paper-based system by using paper credit note. Realizing the lack of efficiency from the viewpoint of both bank operation and Bank Indonesia, PNK was developed. With PNK, participants of bank clearing will simply transmit transaction data in an electronic format without having to send credit notes physically to the organizer. In 2003, preparation for the implementation of PNK has been conducted, including conducting a study and socialization on the architecture that would accommodate the overall process of PNK.

DEVELOPMENT OF PAYMENT INSTRUMENTS

Cash Payment Instruments

Currency in Circulation (UYD)

The position of currency in circulation during the year 2003 tended to increase, albeit lower than the previous year. On average, the currency in circulation grew as much as 11.5%, slightly lower than 11.8% in 2002. Meanwhile, the currency in circulation by the end of December 2003 reached Rp112.8 trillion, an increase of Rp14.3 trillion or 14.6% compared to the previous year, which was only Rp98.4 trillion.

The lower increase of currency in circulation in 2003 was mainly due to a decline in the public's precautionary demand for currency, in line with improved domestic socio-political condition. Meanwhile, currency in circulation still increased in the reporting year driven by enhanced national

Table 9.1
Development of Currency Position

	2002		2003	
	Trillion of Rp	Portion (%)	Trillion of Rp	Portion (%)
Currency in Circulation	98.4	100.0	112.8	100.0
Banknotes	96.2	97.8	110.4	97.9
Coins	2.2	2.2	2.4	2.1

economic activity and price level. The largest monthly increase took place in November and December 2003, mainly due to an increase in demand on the eve of religious holidays' celebration and the New Year of 2004, coupled with government policy to accumulate holidays at the beginning and the end of the week.

The ratio between banknotes and coins and currency in circulation in 2003 was mostly unchanged. The portion of banknotes in currency in circulation was 97.9% (Rp110.4 trillion), while the coins was 2.1% (Rp2.4 trillion).

Currency Procurement and Cash Position

In order to meet public needs for currency, Bank Indonesia, during 2003, procured currency as much as 5.3 billion banknotes worth Rp87.9 trillion and 1.5 billion coins worth Rp445 billion. Most of them were used for replacing worn-out banknotes and coins, which was about Rp72.9 trillion, and the rest was for anticipating any increase in economic demand. In line with Bank Indonesia's cash position by the end of 2003 was quite safe at Rp68.3 trillion, sufficient to fulfill more than 3.6 month of average public demand. This cash position was up by 11.1% from the end of 2002, which was recorded at Rp61.5 trillion (Chart 9.2).

"No Longer Fit for Circulation" Stamping (PTTB)

In addition to procuring currency in sufficient amount, Bank Indonesia maintains the quality of currency held by the public in a good physical quality by withdrawing, destroying, and replacing currencies that are no longer fit for circulation (PTTB). The amount of PTTB in 2003 was worth Rp72.9 trillion, or a 31.7% increase from 2002, which was Rp54.4 trillion (Chart 9.3).

In nominal terms, the largest part of total PTTB currencies consisted of Rp50,000 denomination valued at Rp46.5 trillion (63.8% of total PTTB), followed by Rp20,000 denomination worth Rp10.9 trillion (15.1% of total PTTB). Meanwhile, for the amount of notes, the largest part of total PTTB currencies was the Rp1,000 denomination as many as 1.8 billion notes (37.4%), followed by Rp50,000 denomination as many as 930.5 billion notes (19.2%), and Rp5,000 as many as 682.5 million notes (14.1%).

Development of Cash Inflows and Outflows

Cash inflows nationwide tended to fluctuate. The average monthly cash inflow in 2003 was Rp18.7 trillion or up 9.9% compared to that of 2002, which was recorded at Rp16.9 trillion. Meanwhile, the average

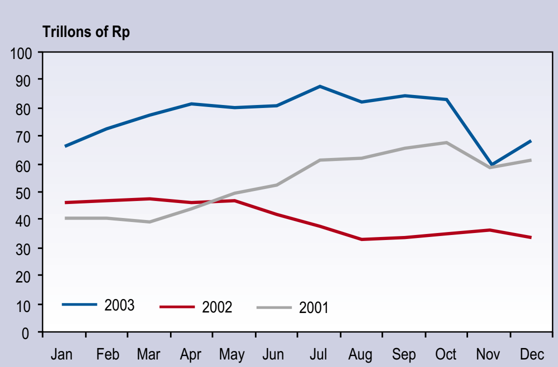


Chart 9.2
Development of Cash Position

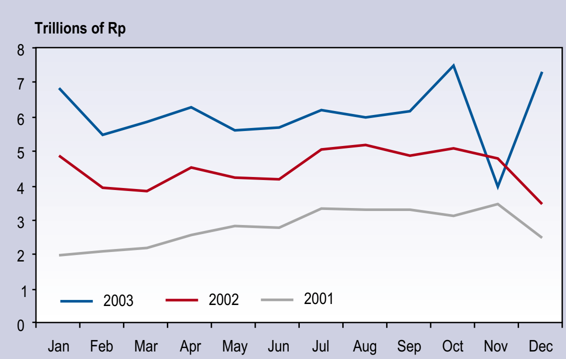


Chart 9.3
Development of PTTB Currencies

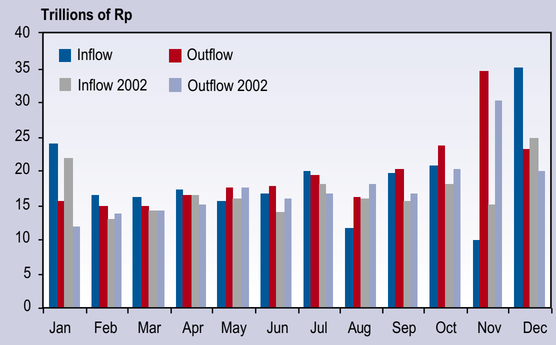


Chart 9.4
Development of Total Inflow and Outflow

Table 9.2
Development of Counterfeit Money Discovery
By Denomination

(Notes)

Denomi nation (Rp)	2001	2002			2003		
		Bank	Polri	Jumlah	Bank	Polri	Jumlah
100,000	427	1,757	1,617	3,374	1,195	16	1,211
50,000	65,465	14,872	59,642	74,514	13,648	2,945	16,593
20,000	25,458	5,319	283,576	288,895	3,457	1,018	4,475
10,000	6,371	2,585	84	2,669	1,217	759	1,976
5,000	307	114	546	660	46	355	401
Total	**98,028**	**24,647**	**345,465**	**370,112**	**19,563**	**5,093**	**24,656**

monthly cash outflow was Rp19.6 trillion or up 11.2% compared to that of 2002, which was recorded at Rp17.6 trillion.

Based on such development, on national basis the net outflow amounted to Rp10.9 trillion, or an average of Rp0.9 trillion/month. Meanwhile, in respect of cash position of BI's branch offices, almost all branch offices outside Java experienced a net cash outflow, while the others in Java, except for Jakarta, experienced a net cash inflow. This occurred mainly due to public spending having flowed mainly to Java (Chart 9.4).

Development of Counterfeiting

The amount of counterfeit money discovered based on the reports provided by banks, National Police (Polri), and Bank Indonesia, in 2003 was 24,656 notes (Rp1.1 billion), or a significant decrease from the previous year (370,112 notes amounted to Rp9.9 billion). Of that total, most notes were of Rp50,000 denomination amounting to 16,593 notes (67.3%), followed by Rp20,000 denomination amounting to 4,475 notes (18.2%), Rp10,000 denomination amounting to 1,976 notes (8.0%), Rp100,000 denomination amounting to 1,211 notes (4.9%), and Rp5,000 denomination amounting to 401 notes (1.6%) (Table 9.2).

A report of counterfeit money discoveries revealed that out of 24,656 notes of counterfeit money discoveries, an amount of 19,563 notes (79.3%) were reported by banks and Bank Indonesia, while the remainder (5,093 notes) by Polri.

Non-Cash Payment Instruments

Development of BI-RTGS Transaction in 2003

BI-RTGS activity in 2003 experienced an increase both in volume and in nominal value in line with the completion of the implementation of BI-RTGS system in all BI's branch offices. Compared to 2002, transaction volume of BI-RTGS in 2003 soared by 93.1% cumulatively, while nominal

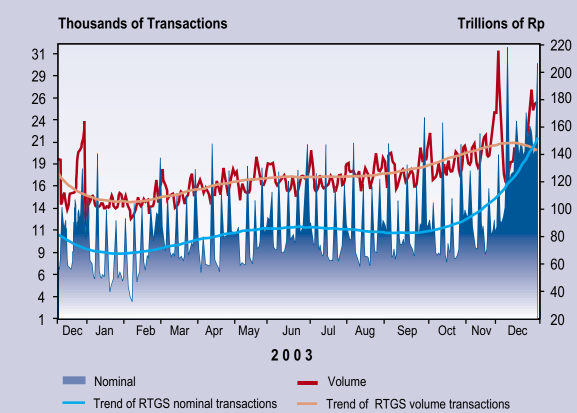


Chart 9.5
Daily Activity of BI-RTGS in 2003

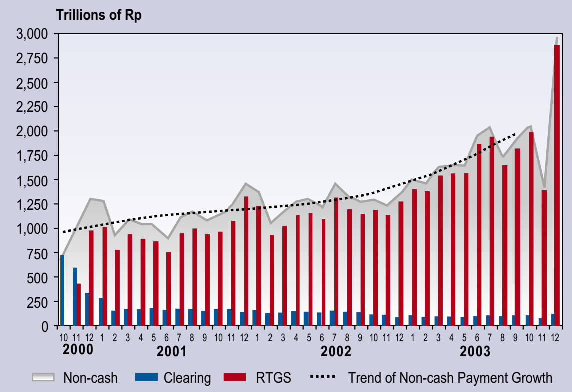


Chart 9.6
Non-Cash Payment System

Table 9.3
Share of BI-RTGS Transactions By Participant

(Percent)

Classification	Share	
	Nominal	Volume
Foreign Bank	10.0	10.2
Joint Bank	2.0	3.3
State-owned Bank	8.2	19.2
Bank Indonesia Bank	66.6	18.0
Regional Development Bank	1.8	3.5
Private National Bank	11.3	46.0

transaction increased by 51.9%. Consequently the average daily volume reached 17,055 transactions, while on nominal basis, the average daily transaction was Rp85.6 trillion. This indicated that in 2003 there was an increase in daily activity compared to that of 2002, i.e. 52.7% (out of Rp55.8 trillion) and 92.3% (out of 8,724 transactions per day) respectively.

Implementation of BI-RTGS system in all BI's branch offices enables banks to transfer funds of large amount or of an urgent nature easily and fast without having to go through local clearing (which takes a longer time), or to interface into the internal system of individual banks in order to pass on such transfer order through branch office that is already capable of implementing BI-RTGS facility.

Table 9.4
Map of BI-RTGS Inter-Account Funds Flows

(Percent)

	Nominal Share	For						Total
		Foreign Bank	Joint Bank	State-owned Bank	Bank Indonesia	Regional Dev. Bank	Private National Bank	
From	Foreign Bank	5.0	0.9	1.8	0.2	0.01	2.1	10.0
	Joint Bank	0.9	0.2	0.3	0.1	0.0	0.6	2.0
	State-owned Bank	1.7	0.2	1.6	1.3	1.3	2.1	8.2
	Bank Indonesia	7.1	3.1	20.2	0.03	7.5	28.6	66.6
	Regional Dev. Bank	0.01	0.0	1.0	0.3	0.2	0.3	1.8
	Private National Bank	2.4	0.7	2.4	0.7	0.2	5.0	11.3
	Total	**17.1**	**5.2**	**27.2**	**2.6**	**9.2**	**38.7**	**100.0**

	Volume Share	For						Total
		Foreign Bank	Joint Bank	State-owned Bank	Bank Indonesia	Regional Dev. Bank	Private National Bank	
From	Foreign Bank	1.7	0.5	2.5	0.1	0.1	5.3	10.2
	Joint Bank	0.5	0.3	0.8	0.1	0.01	1.7	3.3
	State-owned Bank	1.4	0.3	4.9	1.7	1.7	9.3	19.2
	Bank Indonesia	1.1	0.9	3.8	0.2	1.5	10.6	18.0
	Regional Dev. Bank	0.03	0.01	1.5	0.4	0.3	1.1	3.4
	Private National Bank	4.5	1.2	10.4	1.3	0.4	28.0	45.9
	Total	**9.0**	**3.1**	**23.9**	**3.9**	**4.0**	**56.1**	**100.0**

In forms of nominal value of fund transfer transaction, Bank Indonesia made the highest fund transfer transactions, while by volume, national private banks (BUSN) contributed the highest transactions. The high number of transactions made by Bank Indonesia was closely related to the function and role of Bank Indonesia, both as the holder of state treasury and monetary authority. On the other hand, the high transaction volume made by the BUSN was closely connected to the high inter-bank fund transfer activities for the interest of customers. Out of total volume of BI-RTGS transactions carried out by the banks, 74.6% was of transaction for bank customers.

From the information on BI-RTGS transactions Bank Indonesia is able to obtain the profile of fund flow taking place up to now. In general, the map of such fund flow indicates that national private banks are the most active players, especially in relation with the high share of inter-customer bank transfer.

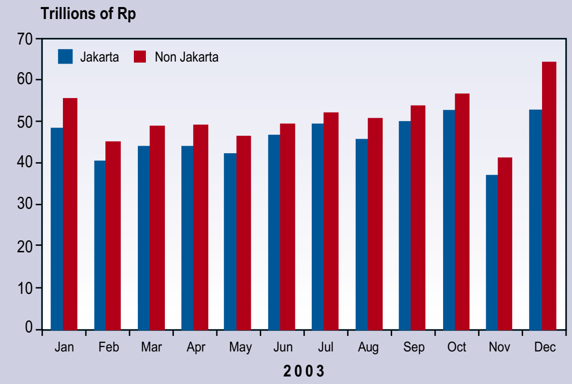


Chart 9.8
Nominal Value of National Clearing

Development of Clearing Transactions

By the end of 2003, nominal value of clearing activities nationwide showed a decrease of 25.4% compared to the previous year, from Rp1,550 trillion to Rp1,157 trillion. Along with the nominal decrease, clearing notes also declined as much as 24.6%, from 72,929 thousand notes to 57,003 thousand notes. This was the consequence of the completion of implementation of BI-RTGS system in all BI's branch offices. On an average daily basis, clearing activities in nominal terms also declined from Rp6.4 trillion to Rp4.7 trillion in 2003. Similarly, the amount of processed transactions declined from 470,000 in 2002 to 301,000 in 2003. Meanwhile, clearing activities in Jakarta region contributed a volume share of 49.0% with a nominal value share of 47.0% from national clearing activity.

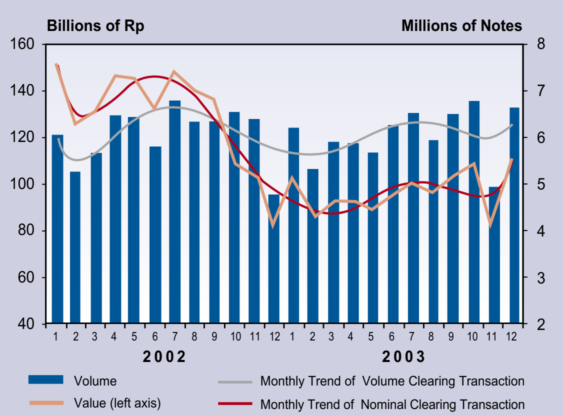


Chart 9.7
Development of National Clearing Transaction

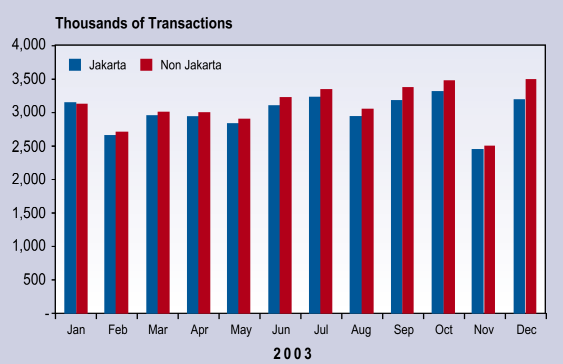


Chart 9.9
Volume of Clearing Deliveries

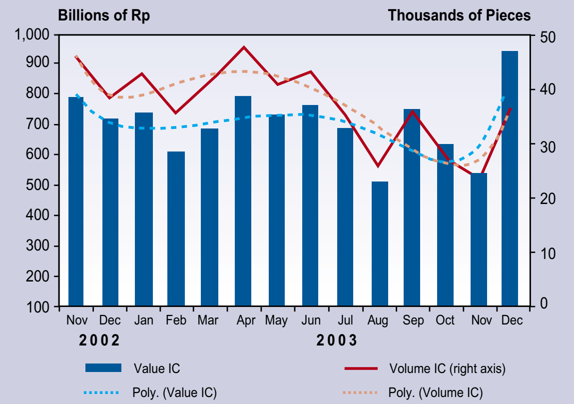


Chart 9.10
Intercity Clearing (IC)

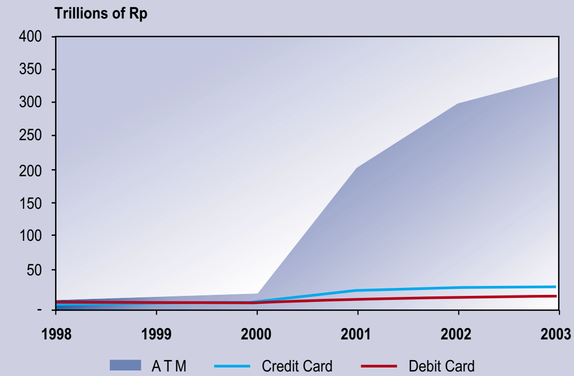


Chart 9.11
Credit Card, Debit Card and ATM Transactions

Inter-city (IC) clearing system activity implemented in October 2002 showed a significant increase. Both volume and nominal value of clearing activities demonstrated an increase of 420.0% and 455.0% respectively, from 84,000 items to 438,000 items, and from Rp1.5 trillion to Rp8.4 trillion respectively. Meanwhile, the average nominal value of daily transaction in 2003 was Rp34.8 billion, or a decline of 23.8%, from Rp43 billion in 2002, while average volume of daily transaction of IC was down as much as 19.1%, from 2,374 items in 2002 to merely 1,808 items in the reporting year.

Development of Card-Based Payment Instruments

In 2003 there was an increased activity in the use of card-based payment instruments, namely, credit cards, debit cards, and ATM cards. Such an increase was due to, among others, the widening network of ATM service, resulted from the rise in the number of both machines and banks becoming the member of switching ATM. Out of the three kinds of card-based payment instrument, ATM was the one with the highest activity, representing as much as Rp342.9 trillion. In the meantime, transaction value of credit cards and debit cards reached Rp25.0 trillion and Rp9.8 trillion respectively. This is because ATM is card-based payment instrument that has the most similar function as money, such that it allows ATM to have the most potential increased activities in comparison with the other card-based payment instruments.

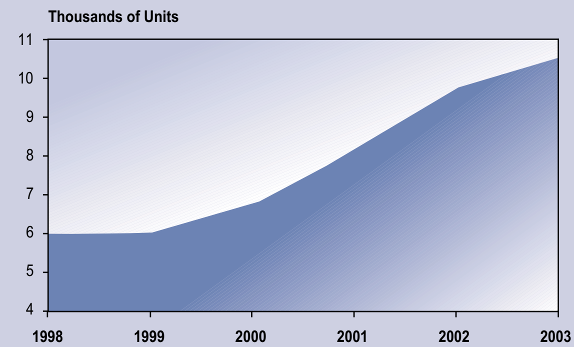


Chart 9.12
Total ATM Machines

Box Drafting of Fund Transfer Bill: BI's 2003 Special Project

Indonesia does not yet have a law specifically regulating the operation of fund transfers. Operation of this function still relies upon each bank's non-standard internal rules as a fund transfer agent. The absence of standard rules have prompted many complaints from customers, as there is no legal certainty concerning the rights and obligations of the various parties; no assurances concerning the date of the fund transfer order; and no explicitly defined responsibilities of involved parties. As for electronic fund transfers (by, for example, ATM, phone banking, SMS banking and internet), disputes often arise over the admission of evidence and settlement.

To prevent more complex problems from arising, Bank Indonesia deems it necessary to initiate the drafting of a Bill on Fund Transfers. The Bill will provide, in detail, all legal aspects of fund transfers, conducted electronically or non-electronically. The regulation is designed to ensure safe, smooth, and efficient fund transfers, to improve efficiency of the payment system as well as to protect the interests of all parties involved in the transfer.

SOME LEGAL ASPECTS OF FUND TRANSFERS

Some of the main legal aspects covered in the provisions of the Fund Transfer Bill are:

1. **Legal Aspects of Fund Transfer Instructions**

   With reference to the principles of an open system and freedom to contract adopted in Book III of the Indonesian Civil Code, the agreement on fund transfer instructions is classified as an untitled agreement (*onbenoemde overeenskomst*) that is not specifically regulated in the Civil Code, so that it may be stipulated in a separate law. Parties involved in the fund transfer agreement are autonomous. This implies that any legal relation can be viewed as a bilateral legal relation between one party and the other one. Such provision is designed to emphasize that, although the fund transfer is a series of activities, the legal relation between each party in the process of fund transfer is regulated on the basis of mutual agreement between the concerned parties.

   Generally, the agreement on fund transfer instructions originates in an agreement concerning the underlying transaction between the sender and the beneficiary. However, the Fund Transfer Bill adopts a principle that the fund transfer agreement shall be separated from the underlying agreement. Accordingly, if the sale and purchase agreement underlying fund transfers is cancelled, then the fund transfer agreement shall not necessarily be cancelled.

2. **Media of Fund Transfer Instructions**

   The Bill on Fund Transfers covers provisions on the conduct of fund transfers transmitted electronically and non-electronically. It also stipulates the acknowledgement of electronic documents and electronic signature as legal evidence.

3. **Execution of Fund Transfer Instructions**

   The Bill stipulates that the execution of a fund transfer instruction is marked with an acceptance by the sending or receiving bank. The acceptance may also be used as an instruction to begin or end the fund transfer process. The Bill also firmly and in detail regulates the time a bank can execute or refuse an acceptance. Once an acceptance has been made, the bank shall not refuse to execute a fund transfer instruction.

4. **Credit and Debit Transfers**

   Although the use of debit transfer services is less frequent than credit transfers, the Bill treats the two modes equally. In the execution of a credit transfer, the originator instructs the receiving bank to pay an amount of money by debiting the originator's account and crediting the receiver's account. By contrast, in debit transfers, the beneficiary instructs the receiving bank to claim an amount of funds by debiting the originator's account and crediting the beneficiary's account. In the execution of a debit transfer, only the *payment leg* side is subject to the Fund Transfers Act, i.e. for the process of payment from originator to beneficiary. On the *claim leg* side, the process of billing from the beneficiary to the originator is not part of a fund transfer activity, because at this stage payment activity has not yet occurred.

5. **Operator of Fund Transfers**

   The Fund Transfers Bill covers fund transfers by both banks and non-bank institutions. This is designed to provide protection to the customer of fund transfer services, by both conventional services and syariah-based services.

6. **Status of Transferred Funds**

   The Fund Transfers Bill stipulates regulations and settlement of fund transfers in the event that the fund transfer operator, particularly banks, are liquidated and legally dissolved. The Bill explicitly states that it does not adopt the principle of *zero hour rules*. This exclusion principle would enable the process of fund transfers in a bank under liquidation to be continued only to the next closest party or passed unto the beneficiary. This is also in line with the principle of *finality of payment*, in which funds that have been received cannot be re-drawn or cancelled.

   Stated another way, the transferred funds are considered to be in the account of the beneficiary if, at the time of liquidation, the funds have been recorded in the account of the beneficiary bank at the central bank, or in a settlement-organizing bank, or in its correspondent bank. In this regard, the beneficiary bank is obligated to pass the funds on to the beneficiary; thereby the sender has fulfilled his obligation. In the event that the fund transfer is related to the obligation of the beneficiary to deliver goods after the funds are received, the fund beneficiary is obliged to immediately deliver the goods purchased by the sender/originator (the principle of *delivery versus payment*).

7. **Domestic and Cross-border Coverage**

   All banks operating in the territory of Indonesia (either national, international, or joint banks) that receive an instruction to transfer funds to or from Indonesia, are subject to the Fund Transfers Act. This Act is applicable at the time when funds transferred are in the territory of Indonesia. In case of conflict, when either all disputants, or one of the disputants, or the funds disputed are in the territory of Indonesia, disputants shall not comply with fund transfer laws of another country.

8. **Settlement of Disputes over Fund Transfers**

   Only a court of justice in the sphere of general adjudication is authorized to try a dispute over execution of fund transfers. The rationale is to emphasize that settlement of fund transfer disputes is not under the jurisdiction of commercial courts. In this regard, out-of-court settlement is still possible, but if dispute resolution is to be through a court of justice, then the court must be one of general adjudication.

The above-mentioned aspects of the Fund Transfers Act reflect the types of problems that have been encountered while a solution has been pending. This Act needs to be supported and complemented by a number of other Bills that are still under discussion and deliberation with the House of Representatives. For example: the Bill on Bank Liquidation; the Bill on Electronic Information and Transactions; the Bill on a Deposit Guarantee Institution; Draft Amendments of Bank Act; the Bill on Post; and the Penal Code Bill. A number of provisions on non-bank institutions that provide fund transfer services covered in the prevailing Bankruptcy Law, also need to be amended.

Chapter 10:
The World Economy and International Cooperation

Chapter 10: The World Economy and International Cooperation

The world economy in 2003 was characterized by low economic growth due to geopolitical instability and the SARS epidemic. Low economic growth and high inflation encouraged a number of countries to apply loose monetary policy, which resulted in lower global interest rate. The world economy was also marked by a weakening dollar as a result of the US twin deficit. Meanwhile, international cooperation focused on efforts to increase economic resilience through crisis prevention and resolution, as well as intensification of regional integration, including efforts to develop regional bond markets.

Global economic growth in the reporting period remained weak, in part due to geopolitical instability and the SARS epidemic in the first half of 2003. These in turn contributed to a disruption of commodity supply in world markets, which limited world trade growth, and pushing up commodity prices. This condition was aggravated by rising protectionism in advanced countries, and the failure of the world trade negotiation in Cancun, Mexico. Higher commodity prices have removed concerns on deflation as they increased inflation, although inflation, and especially core inflation, remained modest. The hesitant economic recovery was insufficient to generate enough employment, and low employment growth encouraged many countries to pursue accommodating monetary policies, which in turn suppressed global interest rates. On the side of exchange rate, the increasing capital flows to developing countries resulting from lower interest rates, coupled with the twin trade and budget deficit in the United States have resulted in a depreciation of the US dollar against most other currencies. Meanwhile improving prospects for the US and Japanese economy in the second semester of 2003 have sparked optimism in stock markets across the globe. On the side of international capital flow, the loose monetary policy in advanced countries and higher yields in developing countries have resulted in rising private capital flows to developing countries, notably in the form of equity investment and commercial loans.

Meanwhile, various international forums discussed ways to increase regional and international financial stability. Among the issues mainly discussed were developing bond market in Asia, integrating financial market in ASEAN including developing the capital market, and liberalizing financial services and capital flows. Progress was made by Indonesia in expanding bilateral swap arrangement. Furthermore, in relation to efforts to enhance private sector involvement in managing crises, a number of broader international forums, such as the IMF, the G-20 and the G-10, have discussed ways to facilitate bonds restructuring through the inclusion of Collective Action Clauses (CACs). Some of these efforts are expected to enable better crisis prevention and resolution in the future.

WORLD ECONOMIC GROWTH

In general, global economic growth was still weak in 2003, although slightly higher than in the preceding year. Modest world economic growth was not enough to fuel significant increases in world trade growth, which was in part suppressed by the outbreak of war in Iraq, the SARS epidemic, and the increasing trade protectionism and failure in the Cancun WTO negotiation. As these obstacles or lost their significance, global economic growth resumed in the second semester of 2003. In the group of advanced countries like the US and Japan,[1] indications of economic recovery had become more apparent at end of the reporting year, while in the European region, which suffered such a low growth in

Table 10.1
Major Economic Indicators

(Percent)

Major Indicator	Actual			IMF Projection September 2003			IMF (Revised) 24 Nov 2003	
	2000	2001	2002	2003	2004	2005-2008	2003	2004
World Output	**4.8**	**2.4**	**3.0**	**3.2**	**4.1**	**4.3**	**3.5**	**4.3**
Major Industrial Countries	**3.5**	**1.0**	**1.8**	**1.8**	**2.9**	**3.0**	**2.0**	**3.0**
United states	3.8	0.3	2.4	2.6	3.9		**2.9**	**4.3**
Japan	2.8	0.4	0.2	2.0	1.4		**2.6**	**1.5**
Euro Zone	3.5	1.5	0.9	0.5	1.9		0.5	2.2
Germany	2.9	0.8	0.2	0.5	1.5		0.1	2.1
France	4.2	2.1	1.2	0.5	2.0		0.1	1.8
Italy	3.1	1.8	0.4	0.4	1.7		0.5	1.8
United Kingdom	3.1	2.1	1.9	1.7	2.4		2.1	3.5
Canada	5.3	1.9	3.3	1.9	3.0		**1.9**	**3.0**
Newly Industrial Countries Asia/Pacific	**8.4**	**0.8**	**4.8**	**2.3**	**4.2**		2.3	4.2
Australia	2.9	2.6	3.6	3	3.5		3.0	3.5
Singapore	9.4	-2.4	2.2	0.5	4.2		0.5	4.2
Korea	9.3	3.1	6.3	2.5	4.7		2.5	4.7
Hong Kong SAR	10.2	0.5	2.3	1.5	2.8		2.0	4.0
Developing countries	**5.7**	**4.1**	**4.6**	**5.0**	**5.6**	**5.9**	**5.4**	**5.9**
Africa	3.0	3.7	3.1	3.7	4.8		3.7	4.8
Asia	6.8	5.8	6.4	6.4	6.5		6.4	6.5
People's Republic of China	8.0	7.5	8.0	7.5	7.5		**8.5**	**8.0**
India	5.4	4.2	4.7	5.6	5.9		5.6	5.9
Malaysia	8.6	0.3	4.1	4.2	5.3		**4.2**	**5.3**
Thailand	4.6	1.9	5.3	5	5.1		**6.0**	**6.2**
Vietnam	5.5	5.0	5.8	6.0	7.0			
Asean-4	5.3	2.9	4.3	4.1	4.4		**4.3**	**4.7**
Latin America	4.0	0.7	-0.1	1.1	3.6		1.4	4.2
Global Inflation							3.9	3.3
Advance Countries	2.2	2.2	1.5	1.8	1.3	2.0	**1.9**	**1.6**
Developing Countries	5.8	5.8	5.3	5.9	4.9	4.0	**5.9**	**4.9**
World Trade Volume	**12.6**	**0.1**	**3.2**	**2.9**	**5.5**	**6.6**		
Imports								
Advanced Countries	11.9	-1.0	2.2	2.8	4.8	6.3		
Developing Countries	**16.1**	**1.6**	**6.0**	**5.1**	**7.8**	**8.0**		
Exports								
Advanced Countries	12.0	-0.8	2.2	1.6	5.2	6.4		
Developing Countries	14.4	2.7	6.5	4.3	6.9	7.4		
International Commodities Price ($)								
Manufacturing	-2.4	2.6	12.8	n.a.	1.7	1.0		
Oil Price	57.0	-14.0	2.81	4.2	-10.5	-4.2		
Non-oil/gas Primary Price	1.8	-4.0	0.6	5.0	2.4	1.3		
Current Account (% GDP)								
Advanced Countries	n.a.	-0.8	-0.7	-0.9	-0.8	-0.6		
Developing Countries		0.5	1.4	1.1	0.4	-0.5		
Countries in transition	20.2	16.2	11.1	10.0	9.2			
LIBOR 6 month Interest Rates								
US $	6.6	3.7	1.9	1.3	2.0			
Euro	4.6	4.2	3.3	2.2	2.4			
Yen	0.3	0.2	0.1	0.1	0.2			

Source : IMF, *World Economic Outlook*, September 2003 & 24 November 2003 the first semester, has begun to enhance growth in the second semester in line with the global economic recovery. Among the group of developing countries, the Asia-Pacific region especially China, Vietnam and India showing the highest growth rates, followed by the Africa region, supported by domestic and export demands. For ASEAN countries, excepting Singapore and South Korea,[2] economic growth was mainly supported by domestic consumption. While investment and export growth was modest in Malaysia and the Philippines, impressive growth supported by rapid private investment growth occurred in Thailand. Meanwhile, the lowest growth was recorded in the Latin America region, although signs of a recovery had become stronger at year end. The group of newly industrial economies likes Singapore and South Korea, suffered lackluster performance, especially because of the SARS epidemic.

Along with the global economic recovery global inflation increased slightly, though it remained modest, especially core inflation. Inflation in developed countries increased from 1.50% in 2002 to 1.90% in 2003, while that in developing countries increased from 5.30% in 2002 to 5.90% in 2003.

The modest economic recovery combined with low inflation encouraged various countries to pursue looser monetary policy and expansionary fiscal policy. The loose monetary policy was reflected in lower benchmark interest rate, among others, the Federal Fund Rate and the Euro Financing Rate, and led to lower international interest rates throughout the first semester of 2003. However, growing inflationary pressure in the second semester resumed the rise of market interest rate. Meanwhile, in line with growing business confidence in the second semester, stock market in most regions, which were under pressure in the first semester, showed a strong recovery in the second semester.

International commodity prices increased quite significantly. Price increases were particularly pronounced in manufacturing and mining commodities, while prices of agricultural commodities tended to be more modest, with the exception of rubber which enjoyed sharp increase, while coffee and pepper prices dropped. Meanwhile, the world price of oil and gas increased sharply because of the war in Iraq and in light of production disruption in several oil producing countries.

The United States

Economic growth in the US is projected to reach 2.9% in 2003, higher than the previous year's 2.4% growth. The U.S. economic recovery gained strength in the third quarter of 2003, which recorded growth of about 8.2% over the previous quarter. The improving outlook was also reflected in growing business confidence as measured by the NAPM indicator, which reached a level of 66.2.[3] These positive developments encouraged the creation of new employment as reflected in declining unemployment figures from 6.0% in 2002 to around 5.7% at the end of 2003 and the drop in initial jobless claims, which dipped under the psychological 400.000 figure. On the supply side, output of the Manufacturing, Construction and Manufacturing sub-sectors showed strong increases. Worries on deflation faded away because of rising demand and weakening dollar. Nevertheless, core inflation remained at a low level (1.1%), and the authorities continued to apply accommodative macro-economic policy.

Despite improving numbers, the US economy was still facing twin deficit issue, the concurrent high deficit in

1 Increased domestic demand and net exports, especially to China and the US were the main drive for economic activities and improved business and consumer confidence, as reflected in the improved Tankan and Nikkei 225 index.

2 In Singapore and South Korea in particular, domestic consumption and investment declined due to the SARS epidemic, although export was expected to improve.

3 Figure over 50 indicate increased activities.

the budget and in the current account. The estimated current account deficit for 2003 reached $550.0 billion, or 5.0% to GDP. Meanwhile, the budget deficit soared to $400.5 billion,[4] far beyond the previous record deficit of $290 billion in 1992. The budget deficit was due to a reduction in tax rates aimed at stimulating the economy as well as higher government expenditures needed to finance the war in Iraq.

European Region

In the European Union, economic growth had been slowing down under shadows of high unemployment, but in the second semester of 2003 recovery resumed. However, economic growth in 2003 is predicted to be around 0.5%, still lower than that of the previous year (0.9%). Meanwhile, eventhough demand remained lackluster, concerns over deflation, especially in Germany subsided, as inflation reached 2.1% (y-o-y) at the end of 2003, slightly above the ECB's 2% target. As for employment, the unemployment rate in the European Union remained worryingly high at 8.8% of the labor force.

To accelerate economic recovery, authorities in the Euro region adopted a loose monetary policy [5] combined with a fiscal stimulus through tax cut program. This policy caused budget deficits in German, French, and Spain exceeding the Maastricht Treaty criterion of 3%. ECB predicted that these fiscal deficits would cause the interest rate to rise as economic growth in European region accelerate. The expansionary policy began to show its effect toward the end of 2003, especially in the two largest countries in the region Germany and France. This was reflected in growing economic activities and rising business confidence as reflected in the IFO survey findings (Germany) and business confidence (France).

4 Up to November

5 On the side of monetary policy, ECB lowered its benchmark refinancing rate from 2.75% at the end of 2002 to 2.0% at the end of 2003

On the external side, the trade balance enjoyed a surplus in line with increasing foreign demand for manufacturing. Growth in such demand was boosted by higher economic growth in the US. Nevertheless, the appreciation of the Euro became an increasing concern for the European Union's competitive position.

For the United Kingdom, economic growth increased from 2.1% in 2002 to an estimated 3.5% in 2003. However, economic growth was considered to be vulnerable because it was mainly driven by the property sector, whereas manufacturing industry grew only marginally. This development had started to affect inflation by year-end, and the Bank of England again raised its benchmark interest rate by 25 bps to 3.75% [6] in November 2003, in order to slow down the rapid growth in credit to the property sector.

Japan

During 2003, Japan's economy grew by about 2.6%, far higher than in the preceding year in which the economy expanded by a meager 0.2%. Economic growth was supported by growth in both domestic and external demand. The performance of the external sector was supported by the rise in machinery and equipment demands in line with the increase in global economic activity, while consumption and investment bolstered domestic demand. Stronger growth in manufacturing and non-manufacturing alike contributed to increasing business confidence as reflected in the rising *Tankan* index. Nevertheless, yen appreciation may threaten improvement in the external sector.

In an effort to escape from repeated economic recessions over the last 10 years and to reduce the relatively high unemployment figure (5.2%), the government of Japan actively sought solutions to settle non-performing

6 Interest rate was lowered by 50 bps in the first three quarters of 2003 from 4.0% at end 2002

loans through corporate and bank restructuring. This restructuring was supported by loose monetary policy, although fiscal policy tightened in order to mitigate the government's budget deficit.

Non-Japan Asia

Among the emerging Asian economies, China recorded the highest growth of roughly 8.5% in 2003, an increase compared to that of the previous year (8%), and supported by domestic as well as external demand. Domestically, consumption grew rapidly as reflected in the growth of retail sales that reach around 10.0%. Meanwhile, investment activities, which contributes almost one third of GDP, also grew rapidly in both public and private sector. Investment was concentrated in infrastructure, factory buildings, as well as office building and real estate. Foreign private enterprises dominated private investment, as FDI reached an estimated $55 billion in 2003. Rapid growth in demand fuelled a rise in inflation from a deflationary –0.8% in 2002 to 0.8% in 2003. In addition, inflation was triggered by rising property prices and a declining yield of harvests as the result of a long dry season and floods.

Malaysia, Thailand and Philippines enjoyed growth similar to that of the previous years, even though growth were affected in the second semester by the impact of the SARS epidemic. Meanwhile Singapore, South Korea, and Hong Kong were hit most severely by the SARS epidemic, and their 2003 economic growth was lower than in 2002. The slowdown of economic growth resulted in rising unemployment. The unemployment rate in Hong Kong reached 8.6%, in Singapore 5.9%, while in South Korea unemployment was 3.6%. Nevertheless, toward the year-end, indications of economic recovery became apparent in the rising exports and consumption, following rising demand in trading partner countries such as the US, China and Japan. To boost domestic economy, monetary authorities in these countries continued to maintain loose monetary policy.

Latin America

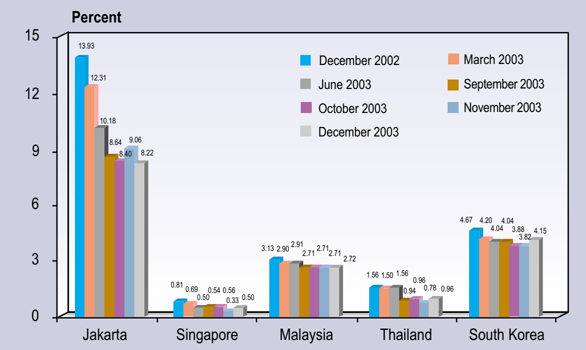
The economy in Latin America continued to grow at a slow pace. Growth was prevalent in big countries like Mexico, Argentina, and Brazil. **Argentina's** economy, which suffered a severe economic crisis in 2000, recovered in line with the improving US economy and positive impact of fiscal and financial restructuring. In 2003, GDP growth bounced back to 8%, from a decline of 10.9 percent in the year before, and in line with the continuous improvements of social and political condition in that country. This increase was especially supported by the external sector, especially exports of seeds, textile products and mining products such as steel and aluminum. The weakening of peso exchange rate since crisis was a key factor behind the improvement of exports. The economic recovery helped to reduce unemployment figures from around 50% of work force post-crisis to 14.3% at the end of 2003.

Meanwhile, **Brazil's** economy began to show signs of recovery, following the loosening of monetary policy.[7] On the fiscal side, the government increased investment expenditures on infrastructure construction and water-power plant, in order to encourage private investment and economic growth and reduce the considerably high unemployment figure (around 13%). On the external side, the trade balance enjoyed a surplus of around $20.5 billion in 2003, consistent with the rising demand for Brazilian products abroad, especially in steel industries.

In contrast, the **Mexican** economy showed declining growth. In addition to deterioration in external sectors, political issues originated from increasing opposition

7 SELIC interest rate was lowered several times from 26.5% at the beginning of June 2003 to 16.0% at the end of 2003.

pressure against reforms, and incomplete implementation of the master plan for fiscal restructuring hindered the government in implementing economic development programs. Relatively low growth occurred in various sectors, especially in manufacturing, and economic growth relied mostly on growth of the service sectors. This condition was aggravated by the rising import of Chinese products. The economy is still recovering from the 2000 crisis and unemployment is stuck at 3.8% of the labor force.



Source : Bloomberg

Chart 10.2
Interbank Money Market Interest Rate of Asian Countries

International Financial Market

Improvements in global economic prospects followed by increasing aggregate demands boosted market interest rates in the second semester after their decline in the first semester. The rise in interest rates in the second semester was followed by increases in bond yields and mortgage rates, causing concerns over increasing interest charges on loan to the emerging property sector. Rising interest rate curtailed the rise of share price for sometime, but improving market confidence and stronger economic prospects sparked optimisms on corporate profits, and eventually drove up share prices across the globe.

In foreign exchange markets, the dollar exchange rate sharply weakened against most other currencies. The weakening dollar cannot be separated from the very high current/trade balance deficit and budget deficits (twin deficit) in the US. The prolonged conflict in Iraq compounded the negative sentiment against the dollar. Among the other currencies, the Australian dollar recorded the highest appreciation against the US dollar, followed by South African rand and New Zealand dollar, whereas euro, poundsterling and yen respectively rated seventh, tenth and eleventh. Meanwhile, in the Asia-Pacific region, the rupiah saw the fifth highest appreciation against the dollar. The G-7 countries, in their meeting at the end of September 2003 agreed to encourage the US to reduce such deficit and to encourage

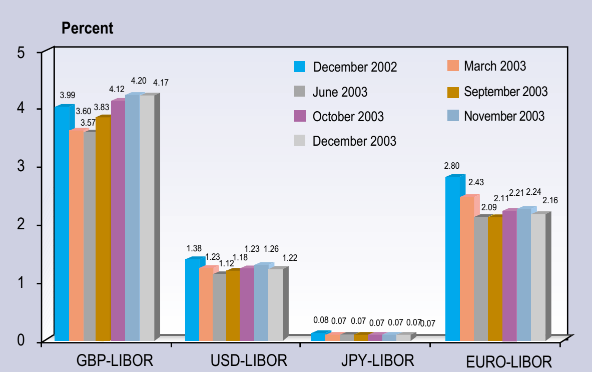
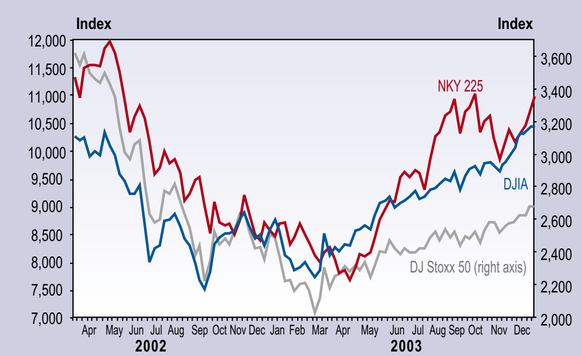
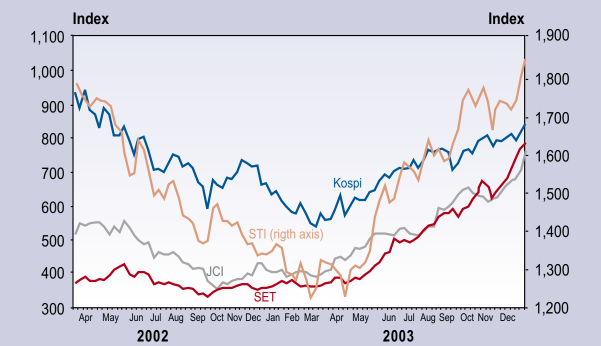


Chart 10.1
LIBOR Interest Rate of Advanced Countries



Source : Bloomberg

Chart 10.3
Main Stock Index



Source : Bloomberg

Chart 10.4
Asian Stock Index

various countries to apply a more flexible exchange rate system.

Capital flows to developing countries showed an upward trend. This was fueled by higher yield, improving economic prospects, and declining country risk. Most net private capital flows, especially equity investment, went to Asia-Pacific region, notably China, whereas flows to ASEAN countries remained unchanged.

Table 10.2
World Major Exchange Rates

(Percent)

Currencies	Apreciation/Depreciation
Australian - dollar	33.9
South African - rand	28.2
New Zealand - dollar	25.0
Brazil - real	22.4
Canadian - dollar	21.2
Swedish - krona	20.9
Euro	20.0
Danish - krone	19.8
Swiss - franc	11.7
British - pound	10.9
Japanese - yen	10.8
Norwegian - krone	4.1
Singapore - dollar	2.1
Taiwan - dollar	2.0
U S A - dollar	n.a.
South Korean - won	-0.5
Mexican - peso	-7.7

Source : Bloomberg

Table 10.3
Asian Main Exchange Rates

(Percent)

Currencies	Appreciation/Depreciation
Australian - dolar	33.9
New Zealand - dollar	25.0
Japanese - yen	10.8
Thailand - bath	8.8
Indonesia - rupiah	6.3
Indian - rupee	5.2
Singapore - dollar	2.1
Taiwan - dollar	2.0
Pakistan - rupee	1.8
Hong Kong - dollar	0.5
China - renminbi	0.0
Malaysian - ringgit	0.0
Sri Lankan - rupee	-0.2
South Korean - won	-0.5
Philippines - Peso	-3.5

Source : Bloomberg

International Commodity Market

Non-Oil/Gas Commodities

International commodity prices continued to increase significantly during 2003. Rising prices were headed by those in industrial commodities related to primary commodities and mining. The rise in agricultural

Table 10.4
External Financing of Developing Countries

(Billions of $)

	2001	2002	2003f	2004f
Current account	26	76.9	91	37.4
External financing, net				
Private capital, net	**126.5**	**124.2**	**187.5**	**196.2**
Capital equity, net	147.5	113.2	124.0	139.3
Direct investment, net	139.8	112.1	93.6	110.7
Portofolio investment, net	7.7	1.1	30.3	28.6
Private creditor,net	-21.0	11.0	63.5	56.9
Commercial bank, net	-26.7	-6.2	18.9	11.9
Non-bank.net	5.8	17.2	44.7	45
Government capital, net	**11.1**	**-4.7**	**-12.9**	**-9.8**
IFIs	22.8	9.7	-5	-5.3
Bilateral creditur	-11.6	-14.3	-12.3	-4.5
Resident borrowings others net	**-76**	**-45.8**	**-6.5**	**-45.2**
Reserves (minus = increase)	**-87.5**	**-150.7**	**-259.1**	**-178.6**

Source : IIF, 15 January 2004

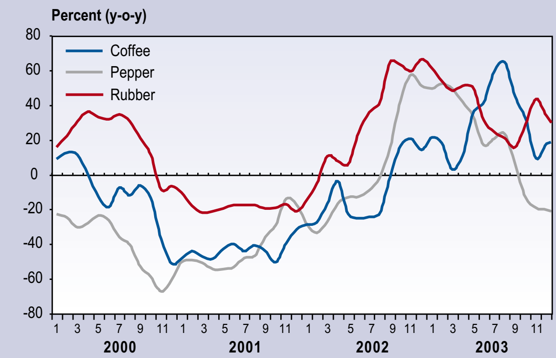
f projected figure

Table 10.5
Foreign Investment Inflows

(Billions of $)

	2000	2001	2002	2003*
China	**40.8**	**46.8**	**52.7**	**55.6**
Hong Kong	61.9	23.8	13.7	14.3
Taiwan	4.9	4.1	1.4	0.8
Japan	7.9	7	9.5	7.1
South Korea	9.3	3.5	2	2.6
ASEAN				
Indonesia	**-4.6**	**-5.9**	**-7.1**	**-10.6**
Malaysia	3.8	0.6	3.2	1.4
Philippines	10.6	0.9	0.3	
Singapore	12.5	10.9	6.1	4.1
Thailand	3.4	3.8	0.9	1.6

Source : JPMorgan, Global Datawatch December 12, 2003
*2003 *year-to-date data annualized*



Source: Various sources (processed)

Chart 10.6
Agriculture Commodity Prices

commodities prices tended to be restricted, with the exception of rubber, the price of which sharply increased due to a shortage of supplies amidst strong demand from China. The price of coffee and peppers, in contrast, fell as a result of abundant supplies in several world production.

Price development in industrial sector tended to vary. Manufacturing commodities that use primary commodities as inputs such as textiles, CPO and wood products, recorded quite a significant price increase. Meanwhile, prices of more technologically intensive manufacturing commodities, such as electrical devices and machines/ mechanics, tended to weaken. The prices of electronic components like DRAM, Chips, IC, and microprocessor, which declined in 2001 and 2002, began to show some increase in 2003.

In contrast, prices of most mining commodities generally increased, with the price of nickel rising most rapidly, followed by those of tin and copper. As in the previous years, rising prices in mining commodities were mainly caused by production cuts aimed at boosting the price.

Oil/Gas Commodities

World oil price continued to increase. At the end of 2003, international oil prices were at a level of about $30.0 per barrel. World's crude oil price of Brent variant reached

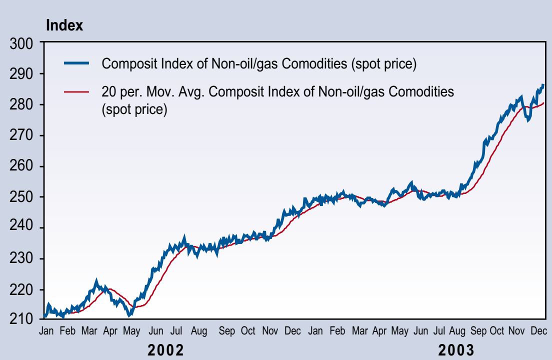
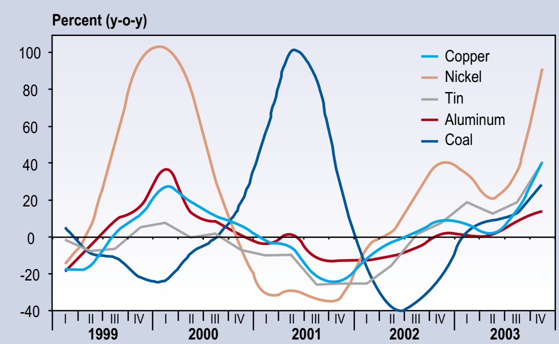
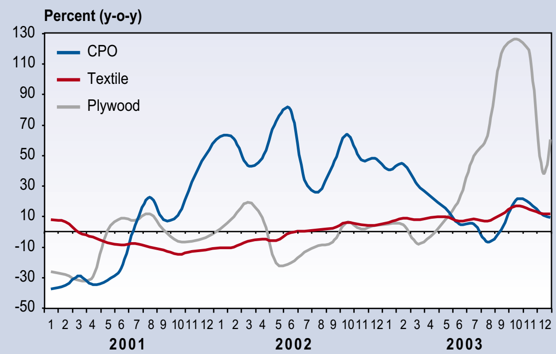


Chart 10.5
Spot Index of Composite Non-oil/gas Commodity Prices



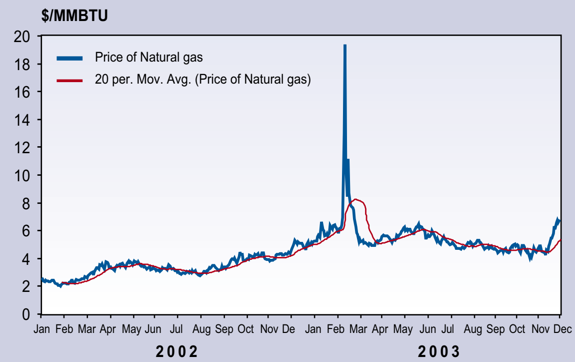
Source: London Metal Exchange

Chart 10.7
Mining Commodity Prices



Source: Various sources (processed)

Chart 10.8
Manufacturing Commodity Prices

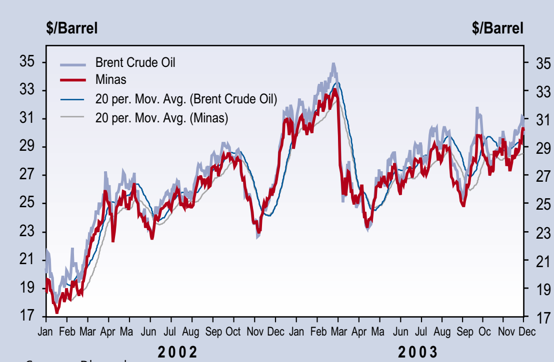


Source: Bloomberg and Energy Intelligence Group

Chart 10.10
Natural Gas Price

a level of $29.3 per barrel, while the price of Minas reached $29.9 per barrel. This rise was mainly caused by the impact of the Iraq war, a decrease in US oil reserves, and a planned OPEC production quota cut. In addition, the socio-political crisis in oil producing countries such as in Nigeria and Venezuela also became the factor in the shortage of supplies.

Meanwhile, the average natural gas price was relatively stable with upward trends in line with the rise in oil prices. A sharp rise occurred in early February as the result of disruption in distribution and negative sentiments caused by the tensions between the US and Iraq. Gas prices regained stability after that, amid abundant supply and



Source: Bloomberg

Grafik 10.9
Crude Oil Prices

gradually growing demand. Increased supplies originated notably from Australia and Russia. The natural gas price (of Henry Hub variant) reached a level of $5.5/MMBTU at the end of the year. The strengthening of natural gas price at the end of 2003 was mainly due to seasonal effect as demand increased with the coming of the winter season in the Northern Hemisphere.

INTERNATIONAL COOPERATION

During the reporting year, discussions in various international forums focused on two broad issues: ongoing issues in international cooperation and organizational aspect of international forums and institutions. In relation to the first, various meetings were held to discuss the development of bond markets, collective action clauses (CACs), bilateral swap arrangement (BSA) in ASEAN+3 [8] forum and the progress in RIA-fin.[9] The second covered official membership of Bank Indonesia at the Bank for International Settlements (BIS), the 12th IMF quota review, agreement on a new rotation scheme as an outcome of the IMF Focus Group as well as review on administrative policies in SEACEN.

8 ASEAN+3 consists of ASEAN member countries plus 3 countries, namely Japan, China and South Korea

9 RIA fin: Roadmap for Integration on Financial and Monetary of ASEAN.

Issues within the Framework of International Cooperation

International cooperation on measures to prevent and manage crisis continued in 2003. Among the efforts to prevent the crisis was the Asian Bond Market development, which was discussed in various fora and saw significant progress in 2003. Effort to cope with crisis through the involvement of private sectors was made by improving debt restructuring mechanisms with the incorporation of CACs into international sovereign bond. Meanwhile, crisis resolution through regional self-help also improved in 2003 along with a growing number of BSAs.

In the ASEAN region, member countries of ASEAN made various efforts for the purpose of improving regional financial integration and stability. The regional financial integration attempt formulated in the Roadmap for Integration of ASEAN (RIA) have developed further, and becomes part of the "ASEAN Vision 2020."

Asian Bond Market Initiatives (ABMI)

The 1997 financial crisis which was, among others, caused by high dependency on bank financing and short term offshore debt financing, as well as undeveloped capital market, has triggered the development of regional bond market in Asia. Besides crisis experience, this initiative was also sparked by the need to utilize the long term fund surplus in Asian region for regional development and investment, the need to reduce considerable dollar investment risks (a significant amount of foreign currency reserves of central banks in Asia are invested in dollar denominated assets), and the desire to overcome risks of currency and maturity mismatch that so far hindered foreign capital inflows into Asian region.

Initiatives to develop this Asian bond market aim to: (i) develop financial and bond market in the region so as to make available relatively secure long-term funds for governments and private entities, (ii) create a liquid bond market to minimize risks of foreign exchange and maturity mismatch, and (iii) promote macro-economic stability by reducing dependency on short term loans.

To develop such bond market, various international cooperation forums involving central banks and ministry of finance of Asia-Pacific countries had conducted intensive discussions. These forums include APEC, EMEAP, ASEAN+3, and the Asian Cooperation Dialogue (ACD) and covered measures taken from several angles, including the **demand** and **supply sides** as well as **political support.** These efforts had progressed significantly in 2003.

The development of the supply side of the bond markets was made in APEC and ASEAN+3 forums. This was realized through continuing issuance of bonds by Asian countries under more attractive new schemes to investors as well as creation of a conducive environment for such issues. The ASEAN+3 forum is developing cooperation to expand bond market access and create a conducive environment for developing such bond markets. To realize this, six working groups (WG) were established, i.e.: (i) Working Group on Creating New Securitized Debt Instrument; (ii) Working Group on Credit Guarantee Mechanisms (iii) Working Group on Foreign Exchange Transactions and Settlement Issues (FXSI); (iv) Working Group on Issuance of Bonds Denominated in Local Currency by Multilateral Development Banks, Government Agencies and Asian Multinational Cooperation (Supranational Bonds); (v) Working Group on Local and Regional Agencies, and (vi) Working Group on Technical Assistance Coordination Group. To increase bond supply in the ASEAN+3 regional market, Thailand as Chief of the Working Group on Creating New Securitized Debt Instrument planned to issue a new securitized debt instrument in the form of local currency denominated Government bonds under withholding tax facilities. Meanwhile, other Working Groups carried out comprehensive and systematic studies to be able to produce a more concrete proposal in developing this bond market.

These studies were deemed necessary because the development of the Asian bond market faced complex issues as the result of different development stages and differences in bond market policies in the respective countries.

Bond market development was also discussed at the APEC Finance Minister Process 2003, and progress was made on three components, i.e.: (i) comprehensive approach to develop strong and healthy bond markets, (ii) initiative to develop securitization and credit guarantee markets, and (iii) initiative to develop new products. Development of these new products is expected to improve the regional bond supplies.

The development on the demand side of the bond markets was furthered in the EMEAP forum through the creation of a mechanism that could encourage accumulation of funds in Asia to be placed into bonds issued by the government, public corporation, and private entities. On June 2, 2003 the EMEAP forum announced the launch of the **Asian Bond Fund (ABF1),** marking an important step in regional bond market development. Through the ABF1 an investment pool was established, the fund of which originated from official foreign currency reserves of central banks from 11 member countries of EMEAP. Total funds in the pool reached $1 billion divided into 10 million equity units valued at $100 per unit. All members of EMEAP absorbed these equities and Bank Indonesia as EMEAP member absorbed about $50 million.

EMEAP members appointed BIS to manage the collected funds (BIS Investment Pool/BISIP) by managing placement on local bonds. BIS invests in local bonds based on the guidelines and regulations agreed by all members of EMEAP. The funds should be invested in dollar denominated bonds issued by governments and institutions guaranteed by member governments of EMEAP, except Japan, Australia and New Zealand, with a minimum collective rating of A-. The selection of the US dollar as the denomination for the bonds was based on the following consideration: 1) most foreign currency reserves of EMEAP member countries are deposited in dollar, and 2) the use of dollar denomination does not require hedging, thereby enhancing the interest of foreign investors. At present, and following the guidelines, all funds of ABF1 have been invested in government bonds of EMEAP member countries, including investment in bonds issued by the Government of the Republic of Indonesia.

To further develop the demand side of the bonds market, EMEAP through the Working Group on Financial Markets is currently conducting discussions to expand the ABF concept to include bonds denominated in regional currencies, conventionally known as ABF2. Such a step is expected to serve as a catalyst to advance the regional bond market and boost bond investments in local currencies.

Meanwhile, political support was initiated through Asian Cooperation Dialogue (ACD) forum.[10] During the second ACD Ministerial Meeting in June 2003 the "Chiang Mai Declaration on Asian Bond Market Development" was issued. This declaration was made as a form of political support for the development of regional bond markets.

Collective Action Clauses in International Sovereign Bonds

One of the efforts to overcome crises is to improve debt-restructuring mechanisms. As the issuance of international sovereign bonds has become common and is used by many countries seeking financing, the international community realized the need to restructure unsustainable sovereign debt on a timely and orderly manner. One of the methods that have been developed and practiced by various countries is to include CACs into international sovereign debt issues.

10 The ACD forum consists of 18 Asian countries including Indonesia.

CACs are clauses contained in bond certificates enabling any country and qualified majority bondholders to make binding decision for all bondholders of a particular bond issue. CACs normally cover two important clauses, i.e., majority restructuring and majority enforcement. A **majority restructuring** clause allows a qualified majority of bondholders to enter into a restructuring agreement with a bond issuer that bind all bondholders for the same bond issue. A **majority enforcement** clause prevents minority bondholders from taking any legal action that may disrupt the restructuring process before a restructuring agreement is reached. Hence, CACs are expected to be able to avoid high economic cost in restructuring bond issuance.

Without specifying CACs, countries facing unsustainable debt burden will face difficulties in restructuring because they need to obtain agreements from all creditors. By specifying the CACs, restructuring negotiated bilaterally with a majority of bondholders automatically binds all other bondholders. In view of the high benefits of CACs, incorporation of CACs is now supported by the IMF as well as international fora such as the G-20 and G-10 countries groups. The IMF has played an active role in promoting application of CACs in sovereign debt instruments.

So far, CACs have been applied to bonds issued under British and Japanese law. However, the majority of bonds issued by developing countries are regulated under New York law, in which CACs were previously not such a common practice. Nevertheless, in 2003, an increasing number of new bond issuance under New York law has included CACs. A majority bond issuance specifying the CACs has been oversubscribed in the market, and no extra premium was charged.

As far as the design of CACs is concerned, some believe it is better not to design a standard clause to allow flexibility for its issuers and creditors. Among bonds issued by various countries, there are variations in the majority restructuring provisions. Bonds issued by Italy, Mexico, South Korea, South Africa and Uruguay use a minimum limit of 75% voting threshold, whereas bonds issued by Belize, Brazil, and Guatemala use a minimum limit of 85% voting threshold for amendment of payment terms.

Bilateral Swap Arrangement

In the spirit of promoting economic resilience in Asian region, member countries of ASEAN+3 have entered into a number of Bilateral Swap Arrangements (BSA), which were part of the Chiang Mai Initiative (CMI) that was launched on 6 May 2000. BSA is a short term financial aid facility in the form of foreign currency exchange swap between two member countries of ASEAN+3 aimed at strengthening foreign currency reserves in order to overcome balance of payments problems. Until 31 December 2003, sixteen BSAs have been signed with a total value of $27.5 billion.[11]

Indonesia, represented by Bank Indonesia, had signed BSAs with the Central Banks of three countries, i.e. Japan (17 February 2003 with a total value of $3 billion), South Korea (24 December 2003 with a total value of $1 billion), and China (30 December 2003 with a total value of $1 billion). The BSA between Indonesia and both China and Japan was dollar-rupiah one-way swap arrangement, while the BSA with South Korea was a dollar-rupiah/won two way swap arrangement. Under one-way exchange agreement one party (in this case China and Japan) only acted as dollar providing country and another (Indonesia) as dollar requesting country. While in two-way agreement, both countries could act as dollar providing and requesting countries, so that they could mutually aid in providing liquidity assistance in term of dollar. For Indonesia, this BSA facility served as precautionary fund resources in line with the Indonesia's graduation from the IMF supported program at the end of 2003.

11 Part of the total BSA amount derived from two-way swap arrangements in which each country under the arrangement could act as both providing and requesting country.

Roadmap for Integration on Financial and Monetary of ASEAN (RIA-fin)

At the 7th ASEAN Finance Minister Meeting (AFMM) in August 2003 in Manila, to realize the "ASEAN Vision 2020," Finance Ministers of ASEAN have entered into an agreement on the Roadmap for Integration of Financial and Monetary Policies of ASEAN (RIA-Fin). RIA-Fin comprises 4 core forms of cooperation, i.e.: (i) Capital Market Development, (ii) Liberalization of Financial Services, (iii) Capital Account Liberalization, and (iv) ASEAN Currency Cooperation. Even though this cooperation is to be carried out in stages, several member countries consider the target of liberalization of financial services and capital traffic flows by 2020 as hard to achieve.

Capital Market Development

The Roadmap for Capital Market Development aims at developing capital markets in ASEAN in order to embody integration of the regional capital markets. Taking into account the different stage of capital market development of each member country, two approaches are taken. The first approach is institutional capacity building covering legal and regulatory framework, market infrastructure, and international best practices. The second approach focuses on inter-capital market cooperation in ASEAN, such as training networks, development of products and market linkages, and harmonization of capital market standard.

Financial Service Liberalization

The roadmap on Financial Service Liberalization is aimed at liberating financial service sectors in ASEAN region using the "positive approach modality". This approach required respective member countries of ASEAN to prepare an indicative list of condition of financial service sub-sector and methods adopted to achieve such liberalization.

Capital Account Liberalization

The roadmap on capital account liberalization is aimed at creating freer capital flows within ASEAN. To achieve this objective, Finance Ministers agreed that the roadmap on capital account liberalization included a careful sequencing. In relation to this point, there are three main stages to follow by each member country before adopting free capital flows in 2020, i.e.: (i) ensure that the capital account liberalization process be taken correctly and subject to the agenda of the respective member countries, (ii) ensure that liberalization be furnished with adequate safeguards against potential macro-economic instability and systemic risks, and (iii) ensure that liberalization benefit the country in question and facilitate closer trade and investment integration in ASEAN region. For this purpose, an inventory has been prepared on capital flow policy implemented by member countries and experiences of the impacts of such policies had been shared.

ASEAN Currency Cooperation

The roadmap on ASEAN Currency Cooperation constituted one of the efforts to promote intra-regional trade and investment through establishment of an ASEAN common currency. However, research findings indicated that the idea of the ASEAN common currency will be hard to materialize at this time. This is because a lot of constraints still exist, including inter-country economic gap, low intra-regional trade volumes and an inadequate regional institutional framework.

Organizational Aspect of International Forum or Institution

In 2003 significant developments took place with respect to international institutions and organizations, including official membership of Bank Indonesia at the Bank for International Settlements (BIS), the 12th IMF quota review, progress of the IMF Focus Group, and a review of the administrative policies of SEACEN.

Bank for International Settlements (BIS)

On 30 September 2003, Bank Indonesia officially became a member of Bank for International Settlements (BIS). Bank Indonesia is the fifth central banks/monetary authorities of countries in ASEAN region to become BIS members up to 2003, after Malaysia, the Philippine, Thailand, and Singapore. Membership in BIS is restricted, and is only possible upon invitation by the Board of Directors of BIS, and after meeting certain requirements.

Established in Basel, Switzerland on 20 January 1930, and starting official operations on 17 May 1930, the BIS was designated to promote cooperation among central banks and provide additional facilities for international finance as well as act as an agent or trustee in settlement of financial problems in international scope. The BIS has two representative offices in Hong Kong and Mexico.

The BIS is a limited company whose share capital was issued and registered in the registry office of Basle, Swiss. The organizational structure of BIS consists of three main legal entities, i.e.: (i) The General Meeting, (ii) The Board of Directors, and (iii) BIS Management. Authorized capital of the BIS is SDR 3 million, consisting of 600,000 shares, 3,000 of which are now owned by Bank Indonesia. BIS assets are generally in the form of sovereign securities of developed countries and international financial institutions. In addition, BIS also holds assets in gold and in credits to central banks. Restriction on BIS membership results in non-liquidity of BIS equity since it cannot not be publicly sold.

Bank Indonesia's membership of BIS enables it to receive benefits including dividend earnings, services and opportunities to participate in activities initiated by the BIS. At present, BIS activities are focused on two main areas as follows:

i) Assisting central bank and other financial authorities to promote financial and monetary stability. Such assistance is given in the form of:
   - Direct contribution toward member countries, among others: (1) facilitating full participation of member countries in the decision-making process at the Annual General Meeting of Members, (2) providing opportunities to participate in training programs, and (3) providing access to BIS financial data.
   - Services to committee established by Governor of the Central Banks as well as encouraging activities of working groups, *inter alia*, Committee on the Global Financial System, Basel Committee on Banking Supervision, and Committee on Payment and Settlement Systems.

ii) Serving as bank for its members by providing financial services.

By becoming a BIS member and participating in its activities, Bank Indonesia is expected to improve effectiveness and efficiency in performing its duties, including in formulating as well as implementing monetary policy, banking, and maintaining stability of the financial system and the payment system. In addition, participation of Bank Indonesia in BIS is expected to promote the confidence of overseas investors in Indonesia, and is considered a means to strengthen cooperation with other central banks.

The International Monetary Fund (IMF)

Quota

In January 2003 the 12th regular 5-year review of quota subscription[12] to the IMF was done. The review was conducted to review liquidity need of the member countries and the capability of IMF to meet those need. In conducting the review, discussions were held at the level of Executive Board during 2 years, covering: (i) the IMF's

12 A member country's quota is used as a basis to determine: (1) member country's voting power; (2) access to IMF's fund resources, particularly IMF's financial facilities, and (3) SDR allocation received by member countries.

role and organization in facing challenges ahead, (ii) the IMF's capital adequacy and possible increase of quota, (iii) the distribution of quota to members and possible amendment of the formula for determining the quota of members, and (iv) governance and representation.

One of the aspects that received significant attention from member countries was the proposal to amend the quota formula. The quota formula used so far has been made taking into account economic aspects including GDP, foreign currency reserves, as well as level of economic openness and its variability. The proposed formula development was to include variability of foreign capital flow. However, since no agreement on such a proposal was reached, the 12th review decided not to increase the quota.

Focus Group

The rapid global financial development in the past several years has posed new challenges to the IMF and its role in maintaining stability of international monetary and financial systems. In relation to this development, several member countries of SEAVG deemed it important for the SEAVG Office[13] in the IMF to be more proactive in its role to represent and protect the interest of the group's member countries in the IMF forum. In line with the expiration of the rotation scheme [14] in 2004 and in order to cope with the issues above, a Focus Group was established. The Focus Group is responsible for preparing the next rotation scheme (2004-2017), improving the effectiveness of the SEAVG Office in serving needs of the member countries and promoting SEAVG's profile at the Executive Board. Since its inception, the Focus Group has conducted several meetings that resulted in recommendation which, among others, covered a rotation scheme for the 2004-2017 period, which received approval from the Governors of SEAVG member countries at the IMF-World Bank Annual Meeting in Dubai on 20 – 24 September 2003.

SEACEN

In the reporting year, the SEACEN Board of Governors in the 22nd meeting [15] reviewed various training and research activities at the SEACEN Center during 2002, and approved the SEACEN center's budget and work programs for 2003. In addition, the Board of Governors also approved the Ministry of Finance of Brunei Darussalam to join as a new member.

By welcoming Brunei Darussalam as a SEACEN member, 12 central banks/monetary authorities from 12 member countries in South East Asia region have joined SEACEN up to 2003. namely Bank Indonesia, Bank of Korea, Bank Negara Malaysia, Bank of Mongolia, Central Bank of Myanmar, Nepal Rastra Bank, Monetary Authority of Singapore, Central Bank of Sri Lanka, Central Bank of China (Taipei), Bank of Thailand, and the Ministry of Finance, Brunei Darussalam.

13 SEAVG office's member countries consist of 12 countries: Malaysia, Thailand, Singapore, Vietnam, Myanmar, Brunei, Cambodia, Nepal, Fiji, Lao, Tonga and Indonesia,

14 Rotation scheme is a rotation of posts (Executive Director, Alternate Executive Director, Senior Advisor, and Advisor) among SEAVG Office's member countries. The rotation is based on the respective members countries' voting power to fulfill the principle of fairness for all members.

15 The meeting is conducted annually and attended by central bank governors and head of monetary authorities of the SEACEN member countries.

Chapter 11: Economic Prospects and Policy Directions

Chapter 11:
Economic Prospects and Policy Directions

Indonesia's economy is forecasted to improve in 2004. Consumption would remain the main contributor to growth, while investment and exports are expected to make larger contributions than in 2003. While constantly taking into account achievement of mid-term inflation target, monetary policy will be carefully geared to support the momentum of sustainable economic recovery.

In general, the prospects for Indonesian economic growth in 2004 are forecasted to strengthen. This prediction is based, among others, on improved economic conditions in most developed countries as well as the healthier state of the domestic economy as reflected in the strengthened exchange rate and relatively low and stable inflation.

On the demand side, economic growth will continue to depend on consumption, and the growth of investment and export will remain relatively low, despite an upward trend. Low inflation and a relatively stable exchange rate are expected to support purchasing power, to encourage private consumption and to spark business investment. In the meantime, improved global economic conditions are predicted to boost non-oil and gas exports.

By sector, economic growth would be driven by increases in all economic sectors with the Manufacturing, Transportation and Communications, and Trade, Hotel and Restaurant sectors being the main contributors. Various activities related to the General Election are predicted to encourage growth in some sectors, including retail trade, manufacturing, transportation and communications, and government services.

Indonesia's Balance of Payments (NPI) are predicted to remain stable in 2004. Exports are predicted to improve consistent with expanding volumes of global trade, while imports would increase significantly, in line with rising domestic activity and exports. In such circumstances, the current account surplus is projected to narrow. Meanwhile, the deficit on capital account would widen in line with large foreign debt repayments, because of the end of foreign debts rescheduling in the Paris Club forum. Private foreign debt repayments would also increase in line with the improved corporate capacity to meet their debt obligations as reflected in declining exceptional financing.

The rupiah exchange rate is predicted to be stable with a tendency to appreciate during 2004. From the fundamental side, international reserves are predicted to decline, but they would be sufficient to maintain balance between demand and supply in the foreign exchange market. From the external side, the likely weakening of the US dollar and the market's continuing positive perceptions following Indonesia's upgraded credit rating would further support rupiah stability. Likewise, the government's policy of fiscal sustainability (including through reduction of the fiscal deficit and successful restructuring of private foreign debts) is predicted to strengthen positive sentiment.

CPI inflation in 2004 is projected to increase relative to the previous year. This is due to a rebound in prices for foodstuffs after favorable supply shocks during the previous year. Meanwhile, core inflation in 2004 is estimated to maintain its downward trend (6.9%).

In line with improving overall economic performance, the banking sector is predicted to improve from previous years in, for example, such activities as extensions of credit and mobilized third party funds. Strengthened expectations of the business world are also predicted to help the domestic business climate, which in turn will increase the demand for bank credit. Consistent with improved intermediation, banks' revenues from credit would also increase in line with rising new credit extensions and improved earning assets.

GLOBAL ECONOMIC PROSPECTS

Economic Growth and World Trade

The global economy is predicted to continue expanding in 2004. The main factors driving the economic activity and world trade are subsiding geopolitical uncertainty and easy macroeconomic policies. However, several issues would still remain, especially in relation to rigid labor markets in the European Union; the twin deficits in the US; and issues in the banking sector in Japan. Despite increasing business activity, inflationary pressures would decline in 2004 due to increasing supplies and declining oil and gas prices. Price pressures would be more noticeable in 2005 as demand continues to increase. This timing would encourage various countries to maintain loose monetary policies at least up to the second semester of 2004. In foreign currency markets, the dollar exchange rate would be stable against the euro, whereas it would weaken slightly against the yuan and the yen. On the side of capital flows, net private capital flows to developing countries, especially foreign direct investment, would continue to rise.

The global economy is projected to grow by 4.3% in 2004, up from 3.5% in 2003 (Table 11.1). This higher world economic growth is supported by a significant growth pick up in some developed countries, such as the US, Japan and the European region which are predicted to grow by 4.3%, 1.5%, and 2.2%, respectively. Global economic growth would be further boosted by the Asian countries, which would expand by more than 6.0%.

The Chinese economy is predicted to grow by some 8.0% in 2004, supported by investment and a huge trade surplus. Other Asian economies like Hong Kong, South Korea, Taiwan, and Singapore, continue to recover from the SARS outbreak. These economies would grow in the range of 4.0%-6.0% in 2004. For its part, Thailand continues to grow rapidly, at an expected rate of 6.2%, fueled by rising exports and domestic consumption. The Malaysian economy is predicted to grow at a rate of about 5.3%.

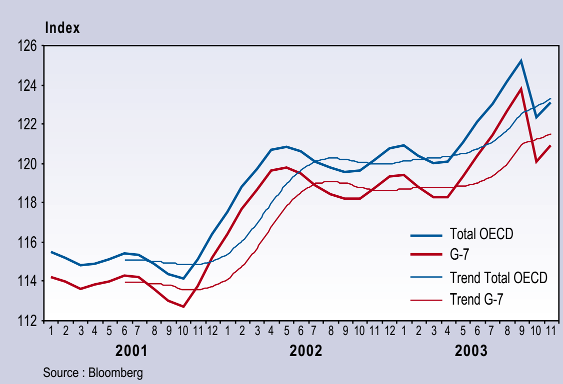


Chart 11.1
OECD Leading Economic Indicators

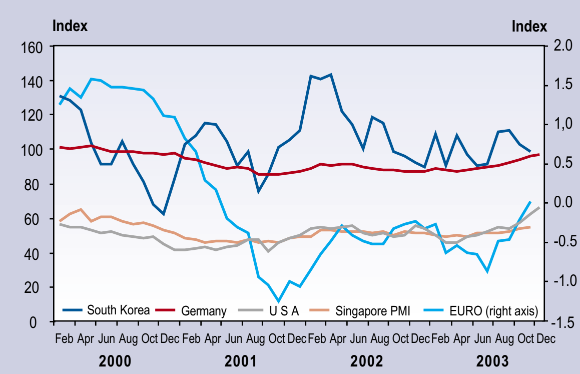


Chart 11.2
Business Confidence I

Table 11.1
Major Economic Indicators

(Percent)

Major Indicator	Actual			IMF Projection September 2003			IMF (Revised) 24 Nov 2003	
	2000	2001	2002	2003	2004	2005-2008	2003	2004
World Output	4.8	2.4	3.0	3.2	4.1	4.3	3.5	4.3
Major Industrial Countries	3.5	1.0	1.8	1.8	2.9	3.0	2.0	3.0
United states	3.8	0.3	2.4	2.6	3.9		2.9	4.3
Japan	2.8	0.4	0.2	2.0	1.4		2.6	1.5
Euro Zone	3.5	1.5	0.9	0.5	1.9		0.5	2.2
Germany	2.9	0.8	0.2	0.5	1.5		0.1	2.1
France	4.2	2.1	1.2	0.5	2.0		0.1	1.8
Italy	3.1	1.8	0.4	0.4	1.7		0.5	1.8
United Kingdom	3.1	2.1	1.9	1.7	2.4		2.1	3.5
Canada	5.3	1.9	3.3	1.9	3.0		1.9	3.0
New Industrial Countries Asia/Pacific	8.4	0.8	4.8	2.3	4.2		2.3	4.2
Australia	2.9	2.6	3.6	3	3.5		3.0	3.5
Singapore	9.4	-2.4	2.2	0.5	4.2		0.5	4.2
Korea	9.3	3.1	6.3	2.5	4.7		2.5	4.7
Hong Kong SAR	10.2	0.5	2.3	1.5	2.8		2.0	4.0
Developing countries	5.7	4.1	4.6	5.0	5.6	5.9	5.4	5.9
Africa	3.0	3.7	3.1	3.7	4.8		3.7	4.8
Asia	6.8	5.8	6.4	6.4	6.5		6.4	6.5
People's Republic of China	8.0	7.5	8.0	7.5	7.5		8.5	8.0
India	5.4	4.2	4.7	5.6	5.9		5.6	5.9
Malaysia	8.6	0.3	4.1	4.2	5.3		4.2	5.3
Thailand	4.6	1.9	5.3	5	5.1		6.0	6.2
Vietnam	5.5	5.0	5.8	6.0	7.0			
Asean-4	5.3	2.9	4.3	4.1	4.4		4.3	4.7
Latin America	4.0	0.7	-0.1	1.1	3.6		1.4	4.2
Global Inflation							3.9	3.3
Advance Countries	2.2	2.2	1.5	1.8	1.3	2.0	1.9	1.6
Developing Countries	5.8	5.8	5.3	5.9	4.9	4.0	5.9	4.9
World Trade Volume	12.6	0.1	3.2	2.9	5.5	6.6		
Imports								
Advance Countries	11.9	-1.0	2.2	2.8	4.8	6.3		
Developing Countries	16.1	1.6	6.0	5.1	7.8	8.0		
Exports								
Advance Countries	12.0	-0.8	2.2	1.6	5.2	6.4		
Developing Countries	14.4	2.7	6.5	4.3	6.9	7.4		
International Commodities Price ($)								
Manufacturing	-2.4	2.6	12.8	n.a.	1.7	1.0		
Oil Price	57.0	-14.0	2.81	4.2	-10.5	-4.2		
Non-oil Primary Price	1.8	-4.0	0.6	5.0	2.4	1.3		
Current Account (% GDP)								
Advance Countries	n.a.	-0.8	-0.7	-0.9	-0.8	-0.6		
Developing Countries		0.5	1.4	1.1	0.4	-0.5		
Countries in transition	20.2	16.2	11.1	10.0	9.2			
LIBOR 6 month Interest Rates								
US $	6.6	3.7	1.9	1.3	2.0			
Euro	4.6	4.2	3.3	2.2	2.4			
Yen	0.3	0.2	0.1	0.1	0.2			

Source : IMF, *World Economic Outlook,* September 2003 & November 24, 2003

Consistent with improving world economic growth, world trade volumes would rise significantly to 5.5% in 2004. This is suggested by, among others, a rise in the leading economic indicators of OECD countries (Chart 11.1) and strengthening optimism of the public and the business world in various key countries as indicated in surveys carried out by NAPM (US), Euro Confidence (Euro), the IFO Institute (Germany), and Tankan (Japan) (Charts 11.2 and 11.3).

Prospects for International Commodity Prices

In line with increasing overall economic activity, primary commodity prices especially for mining and manufactured products, are predicted to increase, albeit

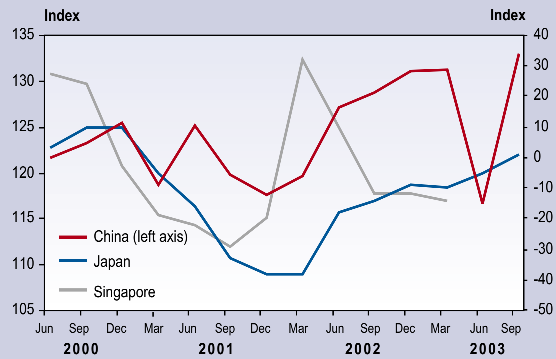


Chart 11.3
Business Confidence II

at a slowing pace than in 2003 (Table 11.2). The factors triggering such high prices are, among others, the downward trend in the US dollar and terrorism threats. Nevertheless, an end to the Iraqi war and the SARS epidemic would boost supplies of commodities and simultaneously minimize obstacles in goods traffic, thereby restraining the rate of price increase.

Meanwhile, the price of oil and gas commodities is estimated to decline in line with a recovery of oil production in Iraq; rising production in non-OPEC countries (especially Russia); and discoveries of new oil reserves in the Caspian Sea, West Africa, Latin America and the US (Table 11.3). However, total oil supply would not increase significantly due to OPEC's policy to reduce production quotas. In these circumstances, the oil price is predicted to average approximately $25 per barrel in 2004, compared with approximately $28.6 per barrel in 2003. In line with these lower oil prices, the price of natural gas is also predicted to decline compared with the previous year. The price of natural gas is predicted to average $3.9 per MMBTU in 2004, which is down by 28.6%.

Table 11.2
International Prices of Oil/Gas and Non-Oil/Gas Commodities

Commodities	Units	Actual					Projection		
		1970	1980	1990	2000	2002	2003	2004	2005
Oil and Gas									
Crude Oil (average)	$/bb	4.31	46.8	22.88	29.01	25.84	27.39	22.82	20.44
Natural gas (AS)	$/mmbtu	0.61	1.97	1.7	4.43	3.48	5.43	3.89	3.58
Non-oil and Gas									
Agriculture									
- Robusta Coffee	c/kg	325.7	411.7	118.2	93.8	68.6	91.2	96.1	94.6
- Shrimp (Mexico)	c/kg	n.a	1462	1069	1554	1090	1240	1323	1379
- Log (Malaysia)	$/cum	153.8	248.2	177.2	195.2	169.4	191.2	195	209.5
- Rubber (Malaysia)	c/kg	145.2	180.8	86.5	71	79.9	98.2	93.4	96.9
Mining									
- Aluminum	$/mt	1982	1848	1639	1592	1400	1437	1478	1533
- Copper	$/mt	5047	2770	2661	1863	1617	1705	1867	1941
- Nickel	$/mt	10147	8275	8864	8876	7021	8475	8818	8174
- Coal	c/kg	n.a	n.a	39.6	726.9	728.0	626.8	727.4	927.59
- Tin	c/kg	1309.6	2129.3	608.5	558.5	421	485.8	518.7	536.4
Manufacture									
- CPO	$/mt	927.1	740.9	289.8	318.8	404.6	439.3	430.5	424
- Copra	$/mt	801.6	574.7	230.7	313.1	276.1	315.3	394.2	429.1
IMF (Changes Percentage)		Actual					Projection		
		1997	1998	1999	2000	2001	2002	2003	2004
World Trade Volume	%	10.9	4.7	5.8	13.3	-0.6	3.3	2.9	5.4
World Trade Prices ($)									
- Manufacture	%	-8.1	-1.7	-1.8	-4.7	-2.4	2.6	12.8	1.7
- Oil	%	-5.4	-32.1	37.5	57	-14.0	2.8	14.2	-10.5
- Primary Commodities	%	-3.1	-14.3	-6.7	4.5	-4.0	0.6	5.0	2.4

Sources:
- Global Economic Prospect 2003
- World Bank
- World Economic Outlook/September 2003
- IMF

Table. 11.3
Estimated Production and Demand for World Oil

(Millions of barrel/ day)

	2003				2004			
	I	II	III	IV	I	II	III	IV
Total Demand	79.7	77.1	78.3	79.9	80.3	78.1	79.6	81.1
OECD	49.3	46.7	48.1	49.3	49.3	47.1	48.8	50.1
United States of America	20	19.6	20.1	20.1	20.3	20.2	20.6	20.8
Others	29.3	27.1	28	29.2	29	26.9	28.2	29.3
Non OECD	30.4	30.4	30.2	30.6	31	31	30.8	31
Total Supply	78.7	78.2	79.1	80.2	79.9	79.7	79.8	80.6
OECD	23.7	22.9	23.5	24	24	23.6	23.9	24.3
Non OECD	54.7	55	55.3	55.9	55.6	55.8	55.6	56
OPEC	30.1	30	30	30.5	30.1	30	29.4	29.6
Others	24.6	25	25.3	25.4	25.5	25.8	26.2	26.4
Changes in Stock	**1.0-**	**1.1**	**-0.8**	**-0.3**	**0.4**	**-1.6**	**-0.2**	**0.5**

Source: US Energy Information Agency - DOE

Inflation and International Financial Markets

Although economic activity and world trade volumes are forecasted to accelerate in 2004, inflationary pressures would not emerge until 2005, due in part to a smaller rise in general commodity prices in 2004 than in the previous year. World inflation in 2004 is forecasted at 3.3%, slightly lower than in 2003 (3.9%).

In these conditions, various countries are forecasted to maintain loose monetary policies at least during the first semester of 2004, and thereafter to gradually tighten macro-economic policies as demand and price pressures increase. In other countries, the United Kingdom in particular, the policy of higher interest rates will occur sooner, due to inflationary pressures being well above target.

On exchange rates, movements of the US dollar against several major foreign currencies will be affected by various factors. Against euro, the US dollar is forecasted to remain relatively stable because further appreciation of the euro is unwelcome as it would hurt exports as the engine of growth. With regards to yen and yuan, the high US trade deficit is due to, among others, those undervalued Asian exchange rates. Hence, the US has requested China to apply a more flexible exchange rate system and has also requested Japan to prevent from intervening against further yen appreciation. The American move is forecasted to affect the appreciation of the yen and yuan, although China and Japan would be reluctant, preferring to protect their foreign trade accounts, which have contributed significantly to economic growth in both countries.

On the international capital side, private capital flows into developing countries, especially in the form of foreign direct investment, are forecasted to increase, particularly to Latin America where yields are still attractive and

Table 11.4
External Financing of Developing Countries

(Billions of $)

	2001	2002	2003f	2004f
Current Account	26	76.9	91	37.4
External Financing, net				
Private Capital, net	**126.5**	**124.2**	**187.5**	**196.2**
Capital equity, net	147.5	113.2	124.0	139.3
Direct investment, net	139.8	112.1	93.6	110.7
Portfolio investment, net	7.7	1.1	30.3	28.6
Private Debtor,net	-21.0	11.0	63.5	56.9
Commercial Bank, net	-26.7	-6.2	18.9	11.9
Non Bank.net	5.8	17.2	44.7	45
Government Capital, net	**11.1**	**-4.7**	**-12.9**	**-9.8**
IFIs	22.8	9.7	-5	-5.3
Bilateral Debtor	-11.6	-14.3	-12.3	-4.5
Resident/Others Borrowing, net	**-76**	**-45.8**	**-6.5**	**-45.2**
Reserve (minus = increase)	**-87.5**	**-150.7**	**-259.1**	**-178.6**

Source : IIF, January 15, 2004

f = projection

Table 11.5
Capital Flows by Regions

(Billions of $)

	2001	2002	2003f	2004f
Private Capital	**126.5**	**124.2**	**187.5**	**196.2**
Latin America	49.4	18.6	26.4	38.8
Europe	17.0	39.6	42.1	52.4
Africa/Middle East	9.2	1.3	5.0	5.5
Asia/Pacific	51.1	64.8	111.3	96.7
Government Capital	**11.1**	**-3.2**	**-5.0**	**-9.1**
Latin America	22.9	7.9	11.1	-1.3
Europe	0.3	4.3	-0.8	-2.8
Africa/Middle East	-3.8	-0.4	-2.6	0.2
Asia/Pacific	-8.3	-15.1	-12.8	-5.2

Source : IIF, January 15, 2004
f projection

prospects for economic growth are good[1]. On the government's side, gross capital outflows from developing countries in the Asia-Pacific region (except India), Europe and Latin America would keep growing in line with the policy of reducing foreign indebtedness (Table 11.5). By contrast, government capital flows into Africa could increase appreciably due to decreased external debts.

PROSPECTS FOR THE INDONESIAN ECONOMY

Aggregate Demand Prospects

Various macro-economic indicators are predicted to remain stable in 2004. On the domestic side, the indicators of macro-economic stability, along with conducive socio-political conditions and the security situation, will raise domestic and international confidence levels that Indonesia's economic prospects are good as reflected, among others, in the steadily declining risk premium and the upgraded debt rating of the Indonesian government. On the international side, the world economy is forecasted to improve in line with expansionary fiscal and monetary policies by the majority of developed countries during the last several years. Conducive domestic conditions are further supported by many post-IMF policies adopted by the government and Bank Indonesia *(Box: The White Paper)*. Implementation of these polices is expected to lead various breakthroughs for accelerating the economic recovery.

Table 11. 6
Forecast of GDP Growth by Expenditures

(Billions of $)

	2003	2004
Private Consumption	4.0	4.0 - 5.0
Government Consumption	9.8	8.7 - 9.7
Investments	1.4	1.6 - 2.6
Exports Goods and Services	4.0	4.0 - 5.0
Imports Goods and Services	2.0	3.2 - 4.2
Gross Domestic Product	4.1	4.0 - 5.0

In light of these developments, economic growth in 2004 is estimated at around 4.0%-5.0% (Table 11.6). This is in line with the consensus of various financial economic institutions, which are forecasting growth in the range of 3.9% - 5.3%, with an average of 4.5%. Improving trends have led many institutions to upgrade their growth forecasts for Indonesia by 0.1%-3.0%. Improving growth prospects were also reflected in surveys of market perceptions conducted by Bank Indonesia. These suggested conducive development of various economic indicators in 2004. (*Box*: *Survey of Market Perceptions)*.

From the demand side, consumption spending is forecasted to continue expanding significantly, while growth in exports and investment would remain low. The low investment growth is due to, among others, considerable idle capacity and limited access to financing as companies' financial conditions have yet to fully recover. Nonetheless, business sector is expected to take advantage of the relatively low interest rate in the the last two years so that they can strengthen their balance sheets and have more access to lower cost financing.

Private consumption growth is predicted at 4.0% - 5% in 2004, higher than in the previous year. This would stem from relatively stable inflation and increased incomes, which taken together raise the purchasing power of the public. In addition, the decreasing interest rates would support the financing of private consumption growth.

1 Higher yield tends to increase portfolio investment inflows. High prospect for economic growth supported with capital market liberalization would attract more Foreign Direct Investment.

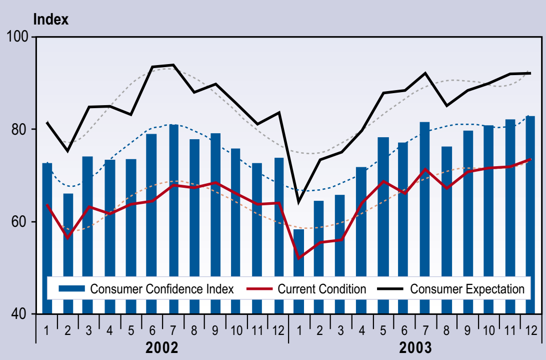


Chart 11.4.
Consumer Confidence Index

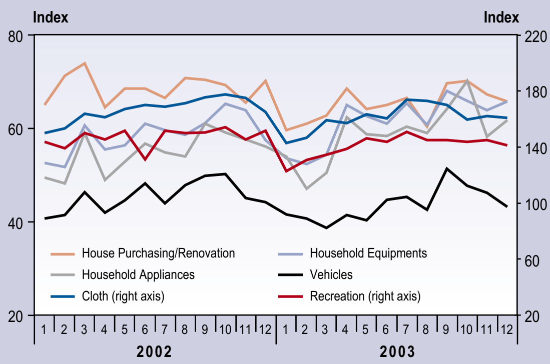


Chart 11.6
Consumption Plan within next 6 - 12 Months

The continuing stable macro-economic conditions would also strengthen consumer confidence. This is reflected in the Consumer Survey, which indicated an improved consumer expectations index in line with improved consumer perceptions regarding conditions at present and six months ahead (Chart 11.4). Improved consumer expectations were driven by heightened confidence in future economic performance, including expectations of more employment opportunities and higher incomes (Chart 11.5). As income expectations improve, especially among the upper middle-class, the purchases of durable goods (like cars, bicycles, and furniture) is likely to increase during the coming six months (Chart 11.6).

For its part, government consumption is forecasted to expand by 8.7% - 9.7%, a bit lower than in 2003. The slight decline is in line with fiscal policy, which tends to be contractionary. This is reflected in the deficit of the 2004 State Budget, which is about 1.2% of GDP versus 1.9% in 2003. For several years ahead, government spending is forecasted to slow in line with the policy priority to hold down the budget deficit and reduce the debt burden.

Investment growth, although not yet significant, is estimated to continue improving in line with rising optimism of the business world regarding the prospects for economic growth and a gradual recovery of real sector conditions; previously business was stuck in the process of financial restructuring. With the support of government

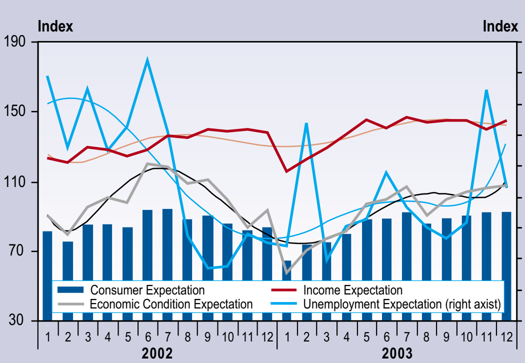


Chart 11.5
Consumer Expectation Index

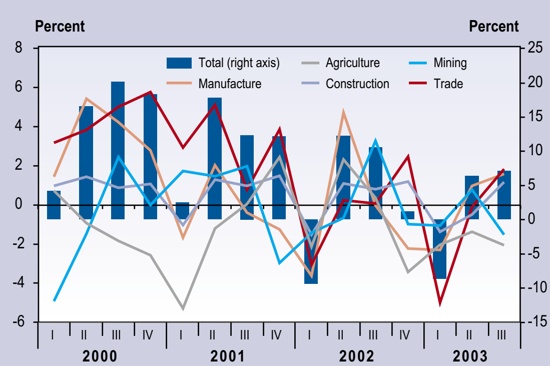


Chart 11.7
Composite Business Survey

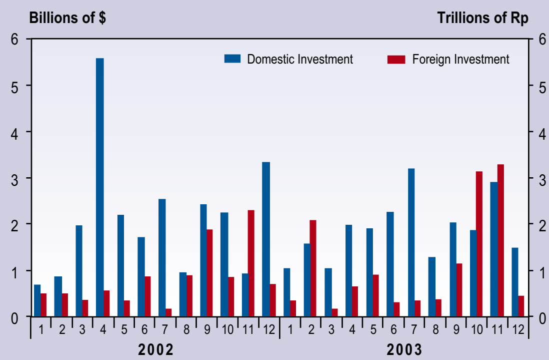


Chart 11.8
Approval of Foreign and Domestic Investments

investment in productive sectors and rehabilitation of various public facilities and infrastructure, overall investment is forecasted to grow by 1.6% - 2.6% in 2004. Optimism about improved investment is further supported by the business survey (SKDU) that indicate an upward trend in almost all business sectors (Chart 11.7). There has also been a sharp increase in approvals of both Foreign Investment (PMA) and Domestic Investment (PMDN). (Chart 11.8)

Weak investment growth is also related to low rates of capacity utilization (Chart 11.9). however this said, capacity utilization in several industries (such as food and beverages industry and non-metal quarrying industry) however is forecasted to turnaround in 2004. Investment will also be undertaken by some industries that have fast

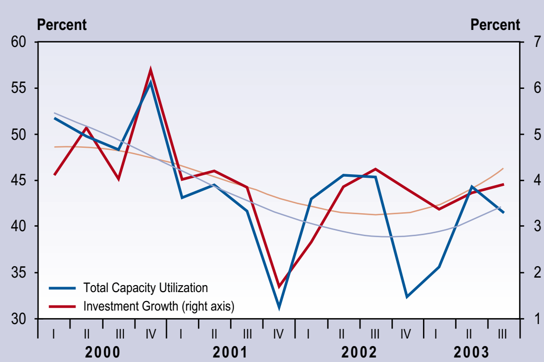


Chart 11.9
Investment Growth and Capacity Utilization

growing domestic markets, such as telecommunications and power plants as well as industry that has been in declining trend of productivity such as those in natural resources exploration. As suggested in the survey of the World Bank, investement in natural resources exploration has the potential to boost investment growth significantly. By contrast, investment in several labor-intensive and export-oriented manufacturing industries is forecasted to shrink, due to tough competition from China and Vietnam, which pay cheaper wages.

On the financing side, investment is finance by bond issuances, bank loans and self-financing. From domestic sources, new bank loan approvals are forecasted to increase in 2004, in line with improved bank lending capacity and sounder corporate finances, following gradual completion of corporate debt restructuring. From foreign sources, improving prospects for economic growth are expected to encourage investors to reallocate some of their funds to Indonesia, so that net capital inflows will increase, despite rising external debt repayments.

For several years to come, investment is forecasted to increase in line with improving long-term prospects for growth and foreign capital inflows. As investment improves, capital productivity (which has been suffering since the onset of the crisis) is forecasted to improve, thereby upgrading the competitiveness of Indonesian products in both export and domestic markets. For that purpose, various macro- and micro-policy strategies and certain institutional improvements are required to strengthen competitiveness and to attract foreign investors.

Export growth is expected to reach 4.0% - 5.0% in 2004, thanks to improved growth of several major trading partners in the European and American regions. Additionally, the increasing world prices of several non-oil and gas commodities (especially minerals and manufactures that have been on the rise or relatively stable) will give an incentive for producers to stimulate exports, especially to traditional markets in the US and Europe. At the same time, however, a trend of tougher competition in global markets must be closely monitored. For example, the growing popularity of free trade agreements (FTA) between developing and developed countries, such as Thailand, Singapore and Philippines entering into FTA with the US, Japan, China and the European Union. In this regard, various policy measures to provide incentives to competitive industrial sectors need to be taken.

Meanwhile, imports are forecasted to increase by 3.2% - 4.2% in line with increasing domestic demand and exports. Import penetration would also increase due to cheaper imports from China and declining competitiveness of domestic products, due to faster increases in production costs than in productivity improvements. However, several other factors could reduce imports. Firstly, there have been pressures to re-impose import tariffs on certain products in order to protect the farming sector and small-scale industries, for example, a possible tariff increase for rice and other farming products. Secondly, there have been shifting trends in global foreign direct investment away from natural resources and manufacturing to service sectors, like telecommunications and trade. These trends could also hold down prices by improving productivity and efficiency in those sectors.

Aggregate Supply Prospects

On the supply side, economic growth in 2004 would be characterized by expansion in all economic sectors, with the main contributors being Manufacturing, Transportation and Communication, and Trade, Hotels and Restaurants. These three sectors' value-added growth would contribute to more than 60% of overall domestic production. Activity surrounding the General Election is forecasted to boost government and private spending, hence increase growth in a number of sectors, e.g. retail trade, manufacturing, transportation, communications and public services. A number of investment projects in real estate, manufacturing, regional infrastructure, water resource, electricity, telecommunications, and oil and gas mining would underpin stronger construction.

Table 11.7
Forecast of GDP Growth by Sectors

(Percent)

Sector	2003	2004
Agriculture	2.5	2.0 - 3.0
Mining and Quarrying	0.5	1.0 - 2.0
Manufacturing	3.5	3.3 - 4.3
Electricity, Water and Gas	6.8	6.5 - 7.5
Construction	6.7	6.4 - 7.4
Trade, Hotel and Restaurant	3.7	3.9 - 4.9
Transportation and Communication	10.7	10.8 - 11.8
Finance, Rental and Service	6.3	6.0 - 7.0
Services	3.4	3.1 - 4.1
Total	**4.1**	**4.0 - 5.0**

Growth in **Manufacturing Sector** is predicted to reach 3.3% - 4.3%. General election related activities would increase the production of certain manufactured commodities, such as foods, beverages and cigarettes, textiles and ready-made outfits, wood commodities as well as paper and printing materials. There would be little new investment in this sector as the rise in demand would be met from existing, idle capacity. Growth in these sector would be reflected in the greater need for working capital credit. In addition, increasing imports of raw materials since last year seem to reflect the response of this sector to expectations of rising domestic demand. Other sources of growth in manufacturing would be from the palm oil and automotive industries. Production of palm oil would increase in line with areal expansion of palm oil plantations and palm oil plants. Automotive output would rise due to rapidly rising demand for motorcycles and Indonesian automotive plants that are designated as an Asian production base for exports.

The **Transportation and Communication Sector** would be one of the economic engines in 2004 with growth of 10.8% – 11.8%. Growth in the Transportation sub-sector will be triggered by prospective investment growth in transport infrastructure and rising sales of automotive products. From the policy side, revision of the Transportation Act and completion of the blueprint for National Communication and Transportation is forecasted to give positive impact on this sector. Airlines expansion by fleet enlargement is also forecasted to continue in view of the high demand for air services. Additional support will come from retail trade, supported by rehabilitation of infrastructure by the government. In the telecommunication sector, increased growth will be due in part to the installation of 3 million additional fixed telephone line units (SST) and the review of tariff structures. Legislative and residential general election activities will also lift transportation, telecommunication, printing and electronic media activities.

Trade, Hotels and Restaurants Sector are forecasted to expand by 3.9% - 4.9% in line with rising domestic consumption, mainly driven by wholesale and retail trade sub-sectors. Expectations of higher retail sales are reflected in new shopping centers, especially in big cities. This stems in part from expectations of improved personal finances as real wages keep improving. The consumer survey confirmed an upgraded consumer expectations index and higher income expectations within the coming 6 – 12 months. The prospect of higher import growth is forecasted to contribute appreciably to growth in this sector. The implementation of AFTA would increase traffic in goods and services among the member countries of ASEAN. In addition, the declining deposits interest rate would drive people to drawdown their savings and use them for consumption. Meanwhile, growth in the Hotels and Restaurants sub-sectors is forecasted to remain sluggish, especially as foreign visitors to Indonesia have yet to return to normal. Growth in these two sub-sectors will be dominated by domestic tourism.

The **Construction Sector** is forecasted to grow by 6.4% - 7.4% in line with the increasing investment in real estate, regional infrastructure, water resources, electricity, telecommunications and oil and gas mining. In real estate, lower interest rates will boost the growth of residential and commercial property projects. In the regional infrastructure sector, growth will occur through infrastructure projects, especially those financed by the government such as roadways, railways, bridges, ports, airports, and irrigation. Several toll roads are to be constructed in 2004, including the west lane Jakarta Outer Ring Road, Makassar-Maros, Bandung-Lembang and Pandaan-Pasuruan. Likewise, the double-tracking of the Java north rail line (Cikampek-Cirebon) and the Java south rail line (Yogyakarta-Solo) are scheduled to be completed in 2004. Meanwhile, construction of the Kupang and Bitung seaports and rehabilitation of the Tanjung Priok port are also scheduled to be completed in 2004. In air transport, the construction of four airports is expected to begin in East Java. They are the Abdurahman Saleh airport in Malang, the Trunojoyo airport in Sumenep, the Gresik airport in Bawean and the Banyuwangi airport. Roadway projects will also be supported by the Surabaya-Madura bridge. Investment projects will also cover development of water resources, for example, the rehabilitation and conservation of a number of dams and lakes.

The **Agricultural Sector** would grow by 2.0% - 3.0%, driven by the plantation sub-sector, especially palm oil plants. In addition, the Food Crops Sub-sector is forecasted to expand with the support of more conducive climate for better production, especially as regards rice. The prospects for growth in food crops would be further supported by the intensification policy, well-maintained fertilizer supplies, the provision of targeted credits and agrobusiness credit, improved irrigation, the planting season acceleration program, review of government purchase prices and special management of commercial rice imports commencing at harvest season. The program would also be supported by an expansion of areas of food crop planting through optimized land utilization, land rehabilitation and conservation as well as land addition by various types of land ecology.

Expansion of the **Financial Sector** is predicted to continue apace, reaching 6.0%–7.0%. One of the sources of increasing value-added in financial sector will be extension of more banking loans due to lower SBI interest rates. Another factor contributing to improved performance of this sector is the banking restructuring process, which is nearly completed. Moreover, the high demand of business for financing gives opportunities for non-bank institutions to keep growing.

Mining and Quarrying Sector is expected to grow by 1.0%-2.0%. The growth is largely due to the Oil and Gas sub-sector, which will be engaged in new exploration activities following the signing of production sharing contracts for eight work zones of oil and gas mining and the bidding for exploration in ten other work zones. In addition, the rehabilitation in 2003 of several oil wells will contribute to 2004 performance of this sub-sector. Gas production will be little changed. Although gas production capacity will increase following the completion of four projects in this sector, several other gas purchase contracts will expire in 2004.

In the **Electricity Sector**, there will be several power generating plant projects within the Java-Madura-Bali system and outside that system. These include the Wonorejo Water Power Generating Plant (PLTA), Sipansihaporas Water Power Generating Plant (PLTA), Tanjung Jati Steam Power Generating Plant (PLTU), and Muara Tawar Gas Power Generating Plant (PLTG). Some of these projects will be accompanied by the construction of a transmission network, i.e., extra high voltage main line in the Java-Madura-Bali system and electrical voltage lines outside the Java-Madura-Bali system. Prospects will be enhanced by ten projects in the area of oil and natural gas which has been announced in the fourth quarter of 2003. The projects will cover the construction of NGL Plaju; Refinery Langit Biru of Cilacap; revamping of Balongan refinery; Flare Gas & Hydrogen Recovery System of Balikpapan refinery; natural Gas Transmission Piping of Pagerdewa in South Sumatera – Cilegon; development of gas resource in South Sumatera; modernization of the Lube Oil Blending Plant of Surabaya; construction of the main transit terminal at Tuban; East Java piping; and construction of the Cikampek Depot.

Balance of Payments Prospects

During 2004, the overall Indonesian Balance of Payments (NPI) is forecasted to be in sizable deficit, mainly caused by capital flows deficit due to external debt payments which entail a reduction in official foreign currency reserves in the amount of $1.1 billion, as against a surplus of $4.2 billion in 2003 (Table 11.8). The reduction in foreign currency reserves was accounted for by a narrower surplus on current transactions and a wider deficit on capital account.

Current transactions are forecasted to record a surplus of $5.8 billion in 2004, versus about $7.7 billion in 2003. This narrower surplus stems mainly from non-oil and gas imports that are forecasted to expand by 9% in contrast to non-oil and gas exports, which would grow by only 5%.

Non-oil and gas export are expected to expand only moderately because several main manufacturesæsuch as textiles and textile products (TPT) and electrical appliances which have been a major non-oil and gas export commoditiesæwill continue to encounter both internal and external difficulties. From the internal side, it is difficult to improve efficiency of these sectors without major new investments, especially in machinery and other capital goods. On the external side, tough competition in world markets and continuing dependence on traditional markets are the main constraints on manufacturing exports.

Table 11.8
Indonesia's Balance of Payments

(Millions of $)

Item	2003*	2004**
A. Current Account	**7,709**	**5,838**
1. Goods Account	**24,438**	**23,234**
a. Exports f.o.b	63,450	63,857
- Non-oil and gas	47,928	50,324
- Oil and gas	15,522	13,533
b. Imports f.o.b	-39,011	-40,623
2. Services (net)	**-16,729**	**-17,396**
B. Capital Account [1]	**-1,656**	**-6,042**
1. Government	**-598**	**-1,154**
2. Private	**-1,059**	**-4,888**
a. Direct Investments	-955	-2,351
b. Portfolio Investments	2,251	2,099
c. Others Investments	-2,355	-4,637
C. Total (A+B)	**6,053**	**-204**
D. Net Errors and Omissions	**-2,446**	**0**
E. Financing	**-3,606**	**204**
Changes in Reserves Assets[2]	**-4,209**	1,140
IMF	**603**	-936
Purchases	1,959	0
Repurchases	-1,356	-936
Notes:		
1. Reserve Assets (IRFCL)	36,246	35,106
In month of imports and		
Official debt repayments	7,1	6,3
2. Current Account/GDP (%)	3,8	2,5

1/ Taking into account the rescheduling
2/ Minus (-) Suplus, and vice versa

The growth of non-oil and gas exports in 2004 will continue to be substantially contributed by agricultural and mining commodities. The prospects for shrimp exports have improved following revocation by the US of alleged dumping and by the European Union of its residue-free shrimp policy. Natural rubber exports are forecasted to increase as China increased its quota for import from Indonesia. More opportunities to increase exports to China will arise with the entry of China into the WTO (*Box: Impact on Indonesia from China's Entry into the WTO).* Furthermore, cooperation among rubber producing countries is expected to maintain price stability, thus enabling Indonesian rubber exports to develop. Some mining products (such as copper and coal) have good prospects, too. Exports of copper are predicted to increase in line with anticipated higher demand from metal component industries abroad. Likewise, the rising trend in coal exports is forecasted to continue, as China (the world biggest coal exporter) reduces its exports to meet soaring domestic demand. Several manufactures also have the potential to develop further as export commodities, including CPO, chemical products, and paper. The expected increase would be in line with strong world demand for those products, supported by ample room for increased production capacity in Indonesia.

Export revenues from oil and gas are forecasted to decline in line with lower international oil prices of $25.0 per barrel in 2004 versus $28.6 in the previous year. The estimate is based on the projection that oil supplies from non-OPEC countries will rise much faster than world demand. In addition, recovery of production in Iraq will increase oil supplies on world markets. These factors will depress world oil prices and induce OPEC to adjust their production quotas. For its part, Indonesia's oil production is forecasted to grow by only 1%, reaching 1,139 million barrel/daily, bringing Indonesia's oil exports to some $6.3 billion in 2004, lower than last year's $7.5 billion. In line with the downward trend of world oil prices, natural gas prices are also forecasted to decline, from $4.8 per MMBTU to $4.0 per MMBTU. Gas exports will be only some $7.2 million in 2004, down 10.3% from the previous year.

Prospects for the services account are even less promising. The service deficit is predicted to reach $17.4 billion, 4.0% wider than in the previous year. The wider deficit is due to, among others, increased freight on imports in line with rising imports and transportation services to other countries. The total number of foreign tourists in 2004 is estimated at only 5.0 million, up moderately from the previous year's 4.4 million. The rise in the number of foreign tourists will boost foreign currency revenues by only $0.5 billion.

On capital account, the deficit is forecasted to widen on both government and private accounts. The government account would record a deficit of $1.2 billion as against $0.6 billion in the previous year. This in partly due to increased foreign debt repayments following an end to government debt rescheduling through the Paris and London Clubs. Government foreign debt repayments in 2004 would be $5.2 billion (exclusive of the IMF), up sharply from 2003's $2.6 billion. Meanwhile, capital inflows in the form of loan withdrawals are forecasted to increase to $4.1 billion, due to program and project loans as well as the issuance of foreign currency bonds..

On private capital account, net inflows of foreign direct investment[2] are predicted to record a deficit of $2.4 billion, higher than 2003's deficit of $0.9 billion. This wider deficit stems, among others, from lower revenues from privatization and strategic sales of bank assets, and rising foreign debt repayments of foreign investment corporations. The latter indicates that foreign investment corporations' capacity to meet their offshore obligations has improved. Capital inflows in the form of investment equity and foreign debts of foreign investment corporations are forecasted to increase by 24% over the previous year. Potential investors are still waiting to assess domestic socio-political conditions after the 2004 general election. However, capital inflows could be higher if oil and gas investment projects promoted by the government in 2003 were to be realized in 2004. Assuming that a large part of these oil and gas investment projects would be undertaken by foreign parties, the large deficit on foreign direct investment could shift into a surplus.

Capital inflows in the form of portfolio investment are forecasted to remain steady, resulting in a net inflow of about $2.1 billion. This stems from the upward trend in corporate debt issuance and domestic interest rates that are still attractive compared to international rates. In addition, the Standard & Poors' and Moody's upgrading of Indonesia's debt rating is a positive signal for foreign investors considering an investment in Indonesia. However, there are factors that need to be monitored because they have the potential to increase risk. First, there is the possibility of a rise in international interest rates in the second semester of 2004. And second, the general election could disrupt public confidence and financial conditions. These factors could reduce capital inflows and even trigger a rush of outflows.

By the end of 2004, official foreign exchange reserves are forecasted to reach $35.1 billion, equivalent to 6.3 months of imports and government external debt repayments.

Exchange Rate Prospects

The relatively stable and upward trend in the rupiah exchange rate in 2003 is forecasted to continue in 2004. This forecast is supported by fundamental factors, conducive external conditions and by positive market sentiment.

From the fundamentals side, a supply and demand of foreign exchange balance can still be maintained. Imports and (public and private) foreign debt repayments would be covered by the available foreign currency supply in the market, which originates from the current account surplus, bank divestments, privatization of state-owned corporations (BUMN) and the sale of government bonds. In addition, the amount of foreign currency reserves is large enough to support exchange rate stability.

On the external side, the huge deficit in the US balance of payments could continue the downward trend in the dollar exchange rate against other currencies, as a readjustment of the trade balance deficit during the past 2 years or so. The global weakening of the US dollar has contributed to rupiah stability and appreciation either directly through global effects or

2 Companies with 10% or more foreign ownership

indirectly through the contagion effect on regional currency developments.

Despite improving prospects of US economy in the second semester of 2004, the remaining considerable deficit in the US trade balance and the potential deterioration of the trade performance of advanced industrial countries in the European region might lead those countries to accommodate a weakening of the dollar and European currencies against a number of Asian currencies. The urge to depreciate against the Asian currencies is growing more and more obvious from the increasing pressure of US and some European countries on China and Japan to apply a more flexible exchange rate policy.

From the sentiment side, sustaining macro-economic stability and a peaceful socio-political situation during 2004 will nurture positive sentiment towards the rupiah exchange rate. In this case, the microeconomic stability would be underwritten by fiscal sustainability. Foreign debt repayment by government and private sector would be high, indicating that the financial structure of both has improved which, in turn, will enable government and private sector to reduce their debt burden (balance sheet effect). This, too, would raise investors' perceptions, especially if international rating institutions were to further upgrade Indonesia's debt rating. Meanwhile, political risk impacting the exchange rate in 2004 is likely to be low as long as indicators of macro-economic fundamentals can be well maintained and stable. As evidence in this regard, the rupiah was little unchanged in the face of the considerable shocks of 2002 (the Bali bombing) and 2003 (the JW Marriott bombing).(Chart 11.10).

Nevertheless, watchfulness is warranted against potential internal and external pressures on the rupiah exchange rate. The main internal concern stems from sizeable excess liquidity in the banking system as disintermediation persists.

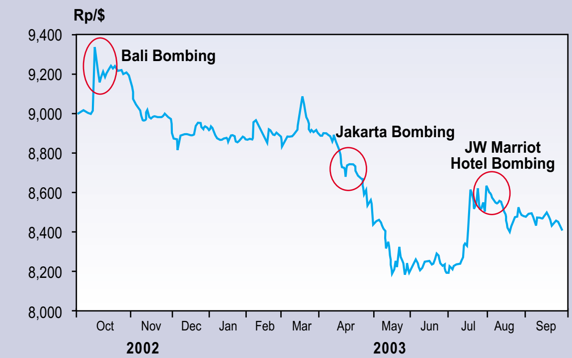


Chart 11.10
Rupiah Resilience Against Various Shocks

The external factors carrying the greatest potential risk stem from the possible changes in global monetary conditions. Possible increases in foreign interest rates could alter international investors' portfolios, which could induce a reversal of capital flows. Interest rates, especially US rates, are forecasted to begin rising in the second semester of 2004 in line with the recovery of the US economy.

Given these various factors, and using the Behavioral Equilibrium Exchange Rate (BEER) model in combination with findings from the Market Perceptions Survey (*Box: Survey of Market Perceptions)*, the rupiah exchange rate during 2004 is estimated to be stable in the range of Rp.8,200 – Rp.8,700 per US dollar.

Inflation Prospects

Inflation is likely to continue declining due to improvements in various factors that exert less and less inflationary pressures. Inflationary expectation would improve due to a stable exchange rate, relatively balanced interaction between aggregate demand and supply, and the less pressure on administered prices. This would lead to inflation to declining trend as reflected in lower core inflation forecast in 2004 and 2005 of 6.9% and 6.2%, respectively.

Unlike core inflation, CPI inflation in the coming two years is forecasted to rise. This is due entirely to the

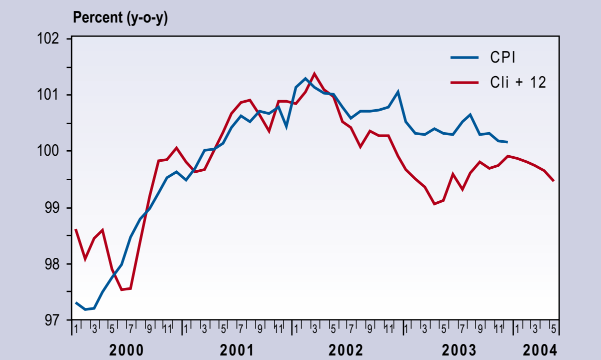


Chart 11.11
Leading Inflation Indicators

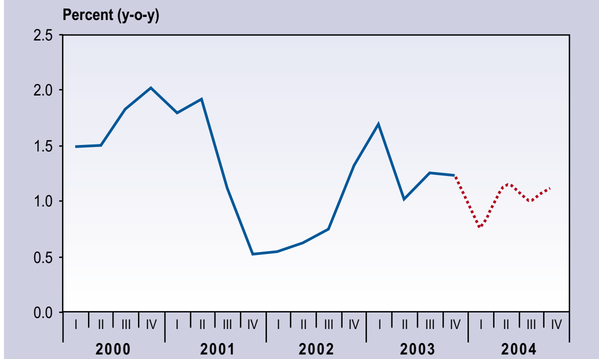


Chart 11.12
Composite Inflation in Several Trading Partners

favorable supply shocks of 2003, especially the price of foodstuffs, which would subside. Consequently, CPI inflation is forecasted at 5.5% in 2004, which is consistent with the leading indicators for inflation that have not reached its peak,[3] implying a rising cyclical direction for 2004 (Chart 11.11). In 2005, CPI inflation is forecasted to be slightly higher than that in 2004, reaching 6%. This increase would stem from, among others, government pricing policy in 2005[4] following some postponements in 2004.

By factors affecting inflation, on the fundamentals side, the **interaction between aggregate demand and supply is expected to exert only mild pressure on inflation in 2004 and 2005.** This expectation is based on mildly accelerating aggregate demand side offset by developments on the aggregate supply side. On the supply side, still-low levels of capacity utilization provide plenty of room to accommodate increase domestic demand. Under the circumstances, the low level of investment in the last two years has yet to warrant concerns over inflationary pressures.

External factors are forecasted to exert no significant inflationary pressure in 2004. This is based on inflationary prospects for several of Indonesia's main trading partners[5], which look benign at present (Chart 11.12). Likewise on the exchange rate side, the anticipated stable exchange rate (in the range Rp.8,200–Rp.8,700 per US dollar) is forecasted to have a minimum pass through impact on inflation.

Inflation expectations in 2004 are estimated to be slightly lower than in 2003. This is due to stronger adaptive expectations (lower inflation rate in 2003) as compare to forward expectation (higher consensus forecast of inflation 2004). (Chart 11.13). This estimate is also in line with the Retail Survey, which shows a lower number of respondents of the view that there would be price increases in the next six months. In 2005,

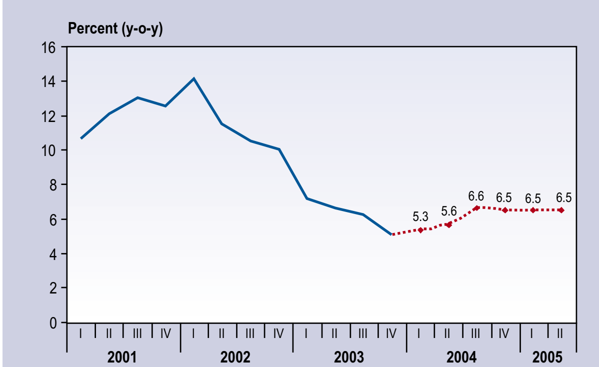


Chart 11.13
Inflation Expectation Based on Consensus Forecast

3 Turning point of economic cycle
4 See Periodogram Analysis in Box: Inlfation Behaviour and General Election
5 Main trading partners refers to countries as major source of Indonesia imports, i.e., Japan, US, Korea, Singapore, China, Thailand, Canada and Malaysia

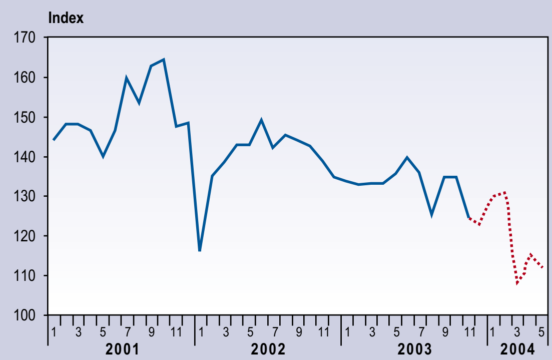


Chart 11.14
Expectation of Retail Sales Price

inflationary expectations are forecasted to keep declining, thanks to improvements in various inflationary determinants.

Unlike in previous years, **government pricing policy** in 2004 is forecasted to entail delayed increase in tariffs and various strategic commodities. Consequently, there would be no immediate inflationary pressure from this factor. Postponements cover fuel prices, which are to be adjusted in line with market prices, and the base electricity power tariff (TDL), which is considered still too low. Similarly, the virtually unchanged target for excise revenue in the State Budget 2004 suggests that no large excise tariff hikes are contemplated. However, the postponements would end in late 2004 and catch-up policies might need to be implemented in 2005.

During the next two years, the favorable supply shock, especially for supply of foodstuffs, would subside. Consequently, the price of volatile foods is forecasted to rise again in 2004 and 2005. This outcome is mainly based on the fact that the growth of foodstuff production within these past few years has been lower than population growth and that some relative price adjustment between foodstuffs and other commodities is likely to happen. However, the extent of the price rise for these volatile food commodities could be reduced by imports, which are expected to be adequate during 2004-05.

Banking Prospects

Banking performance in 2004 is forecasted to improve over the previous year. In line with the forecast rise in GDP, third party funds (DPK) and loans are estimated to expand in the range of 6% – 10% and 15 – 20% respectively. Increase bank intermediation is expected to be followed by improved loan quality, profitability and banking solvency.

The estimated increase in third party funds in 2004 is consistent with the 2003 survey, which showed improved public confidence in the banking sector. By composition, savings deposits are forecasted to increase most as public preference has shifted to short-term deposits because of little difference in interest rates paid on deposit and savings accounts. On the assets side, the main factors boosting credit expansion in 2004 would be the improving business climate and strong consumption spending. Consumption credit would increase the most as consumption would still be the main engine for economic growth.

Business of sharia banks are forecasted to increase appreciably in 2004. With the support of existing policies as well as socialization and education programs, sharia banks' fund raising and financing extended (PYD) activities are expected to increase. Consequently, the market share of sharia banks would reach 1% of total bank assets.

Improved bank conditions is expected to bring positive impact to the continued success of the bank privatization program. So far, this program has promoted better banks performance in terms of greater transparency to national banking, applied good principles of corporate governance and transferred expertise, knowledge, and technical know-how. All those are very helpful in disciplining the market and strengthening the effectiveness of bank supervision.

The main challenge for the banking sector in the future would be the tough competition with other financial market players, especially in the face of ongoing business sector restructuring. In these circumstances, banks will need to improve their business efficiency and boost credit extensions, which is their main function.

In the future, banks will also face various new problems, such as the risk of deteriorating quality of restructured credits and pressures on profitability due to lower earnings from SBIs and recapitalization bonds. Also, the plan to gradually abolish the guarantee program has the potential to trigger transfers of third party funds from small banks to large banks and state-owned banks. Moreover, NPLs are forecasted to increase due to the end of the classification grace period applicable to credits purchased from IBRA.

POLICY DIRECTION AND STRATEGY

Monetary Policy Direction

With due account of economic prospects and the many issues faced especially by the banking sector, monetary policy in 2004 will continue to be directed at achieving the medium-term inflation target of 6% in 2006 (*Box: Medium Term Inflation Target, 2001 Annual Report of Bank Indonesia, and Box: The Amendment to Act No. 23/1999 on Bank Indonesia and Its Implication for the Conduct of Monetary Policy*). To that end, Bank Indonesia will provide economic liquidity in accordance with the economy's needs by guiding base money to grow by 13.0%–14.5%. In addition, to maintain stability in financial markets, Bank Indonesia will continue to use interest rates as its monetary policy signal (*Box: Improvement of Bank Indonesia Framework Monetary Policy).*

This approach to monetary policy is based on the development of excess liquidity in the banks, which is estimated to keep increasing during 2004 due to government financial expansion and the higher cost of monetary control compare with the increase in demand for base money. In implementing monetary policy, Bank Indonesia's main instrument will be SBIs, placed through open market operations (OPT). However, Bank Indonesia will continue its efforts to utilize Government Securities (SUN) and other alternative instruments in lieu of SBIs. In addition, efforts will be taken to encourage use of banks' liquidity excess to finance business activities through bank loan expansion, instead of placements in SBIs.

Regarding the exchange rate, Bank Indonesia's policies will continue to be directed at suppressing exchange rate volatility and keeping it in line with the framework to achieve the medium-term inflation target. By this means uncertainty may be reduced, thereby improving public confidence in macroeconomic stability and helping with business and investment planning.

In order to address the negative impact of possible turbulent capital flows on rupiah stability, several pre-emptive measures will be taken such as enforcement of bank compliance with prudential banking regulations vis-à-vis foreign currency transactions, review of the Bank Indonesia Regulation No. 3/3/2001, and improved management of foreign exchange flows.

Banking Policy Direction

In order to build foundations for optimal banking intermediation, banking policy will be directed towards a sound, strong and efficient banking system that will provide a stable financial system capable of supporting and boosting the national economy. This vision is expanded in the program of Indonesian Banking Architecture (API) released at the beginning of 2004. API is the continuation of a number of banking policies adopted after the crisis some time ago.

API provides a vision that, within the next ten to fifteen years, the national banking structure will comprise a number of international scale banks, national scale banks and specialized banks. In addition, the national banking industry will be bolstered by BPRs and small banks with small-scale activities.

To materialize the grand vision, API has six staged-implementation programs broken down into several activity designs. The six programs will be implemented gradually from 2004 to 2013. Some of the activities designed are expected to be viable in 2004 and could even produce immediate results. Firstly, a customer protection program is expected to develop confidence of the people vis-à-vis the national banking system. Secondly, a risk manager certification program aims to reduce risk faced by banking sectors. Thirdly, a banking expert panel would be established to provide recommendations and strategic direction on regulatory policies needed to improve banking performance.

In anticipation of potential risks, Bank Indonesia continues to promote the application of better risk management by banks through the provision of improved guidelines referred to the *25 Basel Core Principles*. Accordingly, Bank Indonesia's supervisory approach will be adjusted to emphasize risk management. In its implementation, this approach demands specific expertise of bank supervisors and auditors, necessitating continuous training in line with the Second Principle of Basel Document II, *The Supervisory Review Process.*

Result from supervisory review which is oriented toward risk would be included in the CAMEL review with the addition of elements sensitivity to market risk element, thereby creating a CAMELS system. Also, each element of CAMELS will incorporate new variables considered appropriate for market risk. The CAMELS review will be tried out in 2004 before officially applied in 2005.

Moreover, and in light of the end of IBRA's mandate in February 2004, Bank Indonesia plans to revise PBI No. 3/25/PBI/2001, dated December 26, 2001 on the Establishment of Bank Status and Handed Over to IBRA.

With a view to anticipating the development of a fast-growing sharia banking industry, in 2004 a number of regulations will be issued, including: regulation on institutional element, commitment standards; capital adequacy ratios; risk-based supervision; and risk management guidelines for sharia banks. Furthermore, in relation to PSAK No.5 and PAPSI, provision will be made for transparency of financial conditions and for monthly reports by sharia BPRs.

In an effort to boost intermediation through the improvement and expansion of bank services towards UMKM, Bank Indonesia will implement several policies. These will include: technical assistance in the form of training and information dissemination on the banking and real sectors; research on financing of small-scale businesses in several provinces in eastern Indonesia; socialization activities; and an appeal for the government to facilitate the legal provision of loan collateral. Within the framework of credit financing program through Government Treasury Bonds (SUP), Bank Indonesia will continue to assist the government in any way without violating the Act on Bank Indonesia.

Payment System Policy Direction

In the area of the **Cash Payment System**, policy continues to meet public demand for banknotes through increasingly effective currency circulation. In determining the public need for banknotes, Bank Indonesia will take note and consider the seasonal cycle triggering changes in the demand for banknotes. The distribution pattern of small denomination banknotes through third party companies will be maintained in 2004. Revision and evaluation of other issues (such as deposits and payments among commercial banks, use of mobile cash facilities and depository cooperation with commercial banks in areas where there is no Bank Indonesia Branch Office) will be undertaken with a view to improved efficiency. Another important policy will be extension of the anti-counterfeiting network. There will be intensified cooperation with the National Police (POLRI) in the form of training provision to Bank Indonesia Branch Office staffs and Local Police (POLDA) officers to eradicate counterfeit money. Next, to enhance the socialization of the characteristics of authentic rupiah banknotes, Bank Indonesia will cooperate with banks that have office networks down to the rural level, with social and civil foundations or organizations, with Embassies and Consulates General in Hongkong and Singapore, with Immigration and Customs Offices, and with National Police along Indonesia's borders and in other countries.

Meanwhile, policy on the **Non-cash Payment System** in 2004 will be directed at regulating and maintaining smooth operation of the payment system for the creation of an efficient, speedy, safe and reliable national payment system to support financial stability. The aim will be to minimize payment system risk, to improve efficiency and reliability of payment system and to provide consumer protection. For that purpose in 2004, deliberations will be held with the legislative body on the Funds Transfer Bill, development of paperless credit notes (PNK), preparation of a review blueprint on the national payment system, preparation of a failure to settle scheme, continuation of the study on an enhanced role for BPRs in the payment system, and the preparation of an academic document on a strategy for payment system supervision.

Risks and Uncertainties

Despite prospects for improvement in 2004, the macro-economy is still confronted with various risks and uncertainties, both internally and externally. If these can be addressed effectively, the prospects for macroeconomic growth will improve even better than current prediction. By contrast, if the factors are not adequately addressed, macroeconomic prospects will deteriorate.

These risks include:

- Firstly, the process of political transition coupled with the first year without an IMF program. These circumstances could create an increased in uncertainty concerning the continuation of various government programs. In this connection, the implementation of various economic programs already prescribed in the White Paper (which covered economic stabilization, financial sector restructuring, encouragement of investment and exports, and employment opportunities) need to be carried out continuously and consistently.
- Secondly, persistent negative public perceptions of law enforcement and the sense of security. This is reflected in consumer surveys that indicate that the public is still pessimistic and that the government is reluctant to take serious measures to enforce the law and to maintain order and security. Failure to address this issue would further undermine government credibility and slow the recovery of domestic investment.
- Thirdly, the prospects for global economic recovery are clouded by uncertainty, because the recovery in advanced countries is not assured, especially in Europe and Japan. This is reflected in limited business investment and continuing high unemployment in America.
- Fourthly, the potential rise of interest rates could rise in advanced countries, especially the U.S. by end-2004 coupled with the uncertainty in domestic socio-political situation, can cause foreign capital outflows at any time.
- Fifthly, competition in international trade is getting tougher. This trend is obvious from the growing number of developing countries, including ASEAN countries that enter into bilateral FTA with various advanced countries in order to boost their foreign trade. In addition, Indonesia's trading partners are

increasingly imposing non-tariff barriers using issues of health, the environment and terrorism. Imposition of the resultant barriers stifles Indonesian export growth amidst increasing production costs. Furthermore, the entry of competing countries into an FTA makes them more attractive as a destination for potential investors.

- Sixthly, the steady decline in competitiveness of Indonesian products abroad and the weak effort to diversify export products and export destination, hightens our dependency on primary commodities exports and merely certain export destination countries. It is a matter of regret that Indonesia's comparative advantage in natural resources and low wages has not been crafted into an integrated trade and industrial policy with a long-term dimension that stresses sustainability, dominance and new high value-added export products.

Box Survey of Market Perceptions

To support achieving Bank Indonesia's objectives (namely to achieve and maintain stability of the Rupiah as mandated by Act No.23, 1999), prompt data and an accurate outlook for economic conditions are critical. This information is urgently needed to support and strengthen macroeconomic projections made by Bank Indonesia in formulating its forward-looking monetary policy.

In response to this need, since QIV-2001 Bank Indonesia has conducted a Market Perceptions Survey (SPP). This quarterly survey is aimed at assessing market perceptions of domestic economic conditions one month and one year ahead. The projection of economic conditions is captured by various economic indicators, such as inflation, economic growth, the exchange rate, the fiscal deficit/surplus, the balance of payments, investment and other economic indicators. In addition, other specific pieces of information hampering growth can be obtained using this survey.

Concerning survey methodology, the selection of respondents is conducted using 'purposive sampling method' in which the main criterion is a strong reputation for being well-informed in the field. Also, the outcome would be used as reference point in decision-making by the public in related activities. SPP respondents include economists (or economic researchers), market analysts, brokers, academics and bankers who are active in monitoring the development of economic indicators and in making projections. To date, the number of SPP respondents has reached 60, mostly scattered throughout the area of Jakarta, Bogor, Tangerang, Bekasih (Jabotabek) and 12 other BI branch office regions (Surabaya, Bandung, Semarang, Yogyakarta, Medan, Padang, Palembang, Bandarlampung, Banjarmasin, Makassar, Manado and Denpasar

Based on a monitoring of these surveys, notable supplemental information could include: (a) A comparison of survey expectations with the realization figures for several indicators, such as economic growth, inflation, and the rupiah exchange rate; (b) By direction of change, that is, the survey is quite good as reflected in the change in the direction of respondents' projections appeared to be close to the realized figures. Hence, this survey is considered good as a reference for formulate a forward-looking monetary policy.

Nonetheless, improvements will continue to be undertaken with the following agenda:

(a) Extending the projection period for certain economic indicators to 1 and 2 years ahead; (b) adding more regions and respondents, by involving local and international respondents, (c) simplifying the questionnaires and (d) improving the reporting system.

Box Improvements in Bank Indonesia's Framework for Monetary Policy

Under Act No.3 of 2004 on Bank Indonesia which is an amendment to Act No.23 of 1999, Bank Indonesia's tasks have been fundamentally changed as regards monetary management. Under this amendment the objective of monetary policy is now more focused, namely "to achieve and maintain rupiah stability". This is based on the view that maintaining low inflation is a foundation for sustainable long-term economic growth.

Since abandoning the crawling band exchange rate system in 1997, Bank Indonesia has used base money targeting as its framework for monetary policy. Within this framework, every each year Bank Indonesia has set an inflation target and estimated base money growth needed to achieve that target. This approach is based on the Quantity Theory of Money formula, MV = PT. The efficiency of this framework depends largely upon the strength of the correlation between money supply (M) on the one hand, and prices (P) and output (Y) on the other hand, as well as stability in the velocity of money (V). In reality, the relationship between M, P and Y has become weaker and less precise since the crisis.

The experience of Bank Indonesia in using this framework indicates that base money is difficult to control. This is due to the fact that demand for currency by the public has structurally changed since the crisis, using the standard interpretations of transactions and precautionary motives for holding money. Equilibrium between the supply and demand for money has become more demand-determined, leaving Bank Indonesia's influence over money supply to play a secondary role. Consequently, when base money is above its target, controlled management of base money often requires higher interest rates than would be desirable (that is, a tight bias). At the same time, structural changes during the post-crisis era have generated more dynamic interaction between macro and micro variables and increased the role of non-monetary factors in affecting inflation and exchange rates.

Under such conditions, the practice of monetary policy to date has tended to be pragmatic (that is, an eclectic approach), relating policy response to several nominal anchors. This eclectic approach may be inconsistent with sound monetary policy, especially in developing countries where monetary policy has limited credibility. In particular, such a practice is vulnerable to becoming trapped in time inconsistencies, which will eventually increase inflationary expectations.

To enhance the credibility of monetary policy, Bank Indonesia plans to adopt a Full Fledged Inflation Targeting (FFIT) Framework.

INFLATION TARGETING FRAMEWORK

Inflation targeting is a goal of monetary policy that is characterized by public announcement of an inflation target to be achieved within a certain time period when the long-term target is low and stable .

For Bank Indonesia, this monetary policy framework is based on several arguments as follows: (1) The implementation of FFIT would strengthen Bank Indonesia's commitment to control inflation, the sole nominal anchor for policy; (2) The implementation of

FFIT constitutes a means for BI to achieve credibility as an inflation-fighter through commitment to its inflation target; (3) The success of FFIT in a developing country would help the country to eliminate currency mismatches,[1] a problem that is often the cause of exchange rate crises in developing countries, like Indonesia and a number of other Asian countries during the 1997-98 period.[2] (4) Under FFIT the formulation of monetary policy is forward-looking, because monetary policy needs a relatively long time to effect inflation; and (5) Several developed and developing countries have been successful in implementing an inflation targeting framework.[3]

CAVEATS

These benefits to using FFIT in a monetary policy framework, obviously do not mean that FFIT is without weaknesses. Inflation, particularly in developing countries, is more difficult to control due to a number of factors beyond the central bank's influence, uncertainty in the length of time before monetary policy affects inflation and uncertainty in the monetary policy transmission mechanism.

The control of inflation is more difficult to implement if the targeted price index is strongly affected by government policy towards prices (administered prices). Therefore, the implementation of FFIT requires strong coordination between the monetary and fiscal authorities, mainly: in determining the inflation target; on plans for fiscal policy; and on plans to change government policy on prices and incomes.

Adopting FFIT does not guarantee fiscal discipline or prevent fiscal dominance; implying that the government is prone to undertake less tight fiscal policy. Frequently, the central bank would be required to monetize the fiscal spending and eventually hampering the achievement of inflation target. Therefore, the absence of fiscal dominance in all kind of formats and the establishment of institution that could maintain fiscal discipline is a prerequisite for successful FFIT.[4]

From a technical standpoint, two important aspects of FFIT are the central bank's capabilities in inflation forecasting and its understanding of monetary policy transmission. To forecast inflation, a number of econometric models (partial and simultaneous for inflation projections or other macroeconomic purposes) have been developed at BI and have been used on a routine basis. These models are complemented by several supporting tools such as inflation cycles, a diffusion index, leading inflation indicators, leading economic indicators and information variables.

As regards understanding the monetary policy transmission mechanism, a great deal of research has been conducted by Bank Indonesia to assess the transmission mechanism through the interest rate channel, bank lending and firms' balance sheet channels, the exchange rate channel, and the expectations channel. Overall, the outcome shows that contractive (in contrast to expansive) monetary policy tends to have a faster transmission process to the real sector due to weak banking and corporate conditions. A rise in interest rates will lead to a

1 'Currency mismatch' describes a situation in which the currency denomination of a country's assets is different than its liabilities, leaving its net-worth very vulnerable to exchange rate changes. Some authors use the term "balance sheet vulnerability" (Dornbush, 1998) or "international illiquidity" (Chang and Velasco, 1999).

2 Goldstein (2001)

3 See Mishkin and Schmidt-Hebbel (2001), Bernanke, et al (1999) and Corbo, et al (2000).

4 Masson et al. (1997).

deterioration in banks' and corporations' balance sheets, thereby reducing investment and lowering inflation. Also, the impact of monetary policy on the real sector is asymmetric, i.e., it is relatively weak during monetary expansion due to higher risk premiums, both in decisions to channel credits and in investing in the real sector.

As regards the exchange rate channel, this study concludes that the impact of higher interest rates on the exchange rate is currently quite weak due to the large risk premium in the foreign exchange market since the crisis. Another important finding is that the direct pass-through effect of exchange rate on inflation is transmitted very fast, i.e., one month, while the indirect pass through starts to occur after two months.

THE DESIGN OF AN INFLATION TARGETING FRAMEWORK

The design of an inflation targeting framework covers three elements, namely the measure of inflation to be targeted; point versus range of inflation target; and the level of the inflation target. In regard to the type of inflation target, Bank Indonesia uses the Consumer Price Index (CPI) as its target inflation rate. The CPI was chosen because of its recognition, that is, it is widely known by the public at large. In addition, a change in CPI will directly affect the public's real income.

However, in formulating monetary policy, Bank Indonesia uses core inflation as an indicator to measure underlying inflationary pressures and to undertake policy responses. This is due to the fact that changes in the CPI are often affected by government price and income policies and wide fluctuations in several commodities, such as food, due to successes/failures in harvests that are beyond the control of monetary policy.

The BI target for inflation is provided in the form of a mid-point with a specified deviation. The mid-point target is intended to provide a clear direction to the public on how the targeted level is to be achieved by the central bank. Additionally, this would help clarify the accountability and commitment of Bank Indonesia to achieving the target.

The Time Frame for Achieving the Target

In setting its target, Bank Indonesia shall set an inflation target for the next 5 years with a declining, staged annual target for inflation.

Operation Procedures for Monetary Policy

The operational target to be used under this Inflation Targeting framework is the interest rate. The pragmatic consideration in using interest rates as the main monetary policy instrument is due to the fact that the public absorbs monetary policy signals more easily through interest rates than through base money.

For policy responses, a Taylor-type rule[5] is recommended. Essentially, the interest rate (used as the monetary policy instrument) would respond directly to the inflation gap (difference between projected inflation and its target) and the output gap (difference between potential and actual output).

This rule will not be used mechanically; rather, it will be a benchmark. Considerable judgment will be needed due to uncertainty in the transmission of changes in interest rates to inflation, as well as the effectiveness of monetary policy in gradually and

5 Taylor rule is a benchmark policy reaction function commonly used by central banks in determining interest rate level.

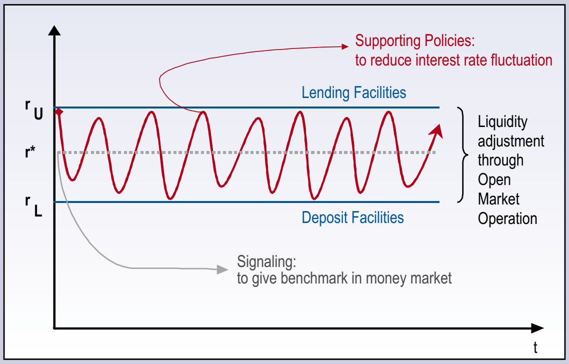


Chart 1.
3 Function Linkages on Instrument Mix

consistently affecting interest rates. Use of this rule will also take into account the importance of interest rate stability.

The overnight money market interest rate will be used as the operational target, with a mixed instrument approach aimed at satisfying 3 functions: liquidity adjustments; standing facilities limiting interest rate movements; and a signaling function. This holistic management approach is indispensable mainly because one instrument is allowed to have more than one function, making for clear interdependence among the instruments, as indicated in Chart 1.

Transparency, Communication and Accountability

Transparency and communication are crucial aspects of inflation targeting. To enhance the effectiveness of monetary policy, any change in policy and the reasons for change need to be clearly announced to the public. Such transparency would enhance the effectiveness of monetary policy by shortening the length of time before monetary policy has an impact. The communication aspect could be undertaken through press releases, speeches, and discussions between Bank Indonesia officials with the public, economists, and quarterly reports to the House. Transparency could be further improved through an Inflation Report containing Bank Indonesia's view on the direction of the economy and inflation and through a clear publication on how the policies are formulated.

From the accountability point of view, Act No.23 of 1999 and Act No.3 of 2004 stipulates the mechanism for implementation of Bank Indonesia's tasks and authority to the public, both directly through the mass media and through the House. Under article 58 of the amendment act, it was explicitly mentioned that Bank Indonesia is obliged to submit a written annual report to the House and the Government at the beginning of every fiscal year. Submission of the annual report to the House constitutes one aspect of accountability and source of information for the Government. In addition to the annual report, Bank Indonesia is also required to submit a quarterly report; these reports can be used to evaluate the performance of the Board of Governors and Bank Indonesia. This information is also directed to the public to be used as an important reference point on monetary policy for market players.

Box The Amendment to Act No. 23/1999 on Bank Indonesia and Its Implications for the Conduct of Monetary Policy

After 4 prolonged years, efforts to amend Act No. 23 of 1999 concerning Bank Indonesia eventually ended when an amended act was approved by the House of Representatives in December 2003. The amendment consists of 18 amended articles, 2 new articles and 2 new annotations. The amendments associated with issues of monetary policy included the objective (article 7), inflation targeting (article 10), credits (article 11), government bond issuance (article 55), and accountability (articles 38, 58, and 58A).

OBJECTIVE

Bank Indonesia's objective remains unchanged, namely to attain and maintain stability in the value of the rupiah. Under the amended act, the conduct of monetary policy shall take into account government economic policies, including developments in fiscal operations and the real sector. Monetary policy is to be conducted in a sustainable, consistent and transparent manner, so that it can be used as a reference point for the business community and the public at large. To date, the implementation of Bank Indonesia monetary policy has taken into account developments in the fiscal and real sectors. As indicated by this commentary, the amendment reconfirms Bank Indonesia's objective as stated in article 4 of Act No. 23/1999.

This amendment maintains a duality in the central bank's objective embodied in the term "rupiah value". So far there is no firm statement that Bank Indonesia's objective is solely to achieve a stable, low inflation rate, despite inflation have become the main target and not the exchange rate (following the adoption of freely floating exchange rate system).

INFLATION TARGET

It is stated in article 10 of the Act No. 23/1999 that the inflation target is determined by Bank Indonesia. In this amendment, it is the government who determines the inflation target. Within this framework, the government in consultation with Bank Indonesia will consider various issues, including the determination of administered prices, real sector policies, and various macro-economic assumptions. Having the government set the inflation target is a positive development, because it will give the government more interest in achieving the inflation target. In the same way, the government will have more commitment and discipline in contributing to the inflation target through its fiscal and real sector policies.

Several important aspects in determining the target to be included in these consultations are: (1) the type of inflation target, that is, whether overall CPI or core inflation; (2) the level and path of the medium-term target, that is, whether a gradual or drastic decline; (3) width of the target, that is, whether it is a point or a range; and (4) the time frame for the target, that is 5 years, 2 years, or annual.

Taking into account the variety of possible shocks in one year, when the inflation target is missed, Bank Indonesia needs to explain to the public (including the House) whether the deviation was due to incorrect monetary policy, incorrect initial assumptions, shocks in demand or supply, or changes in administered prices that deviated widely from the initial plan. If the inflation target is determined for the medium-term path (5 years), it needs to be agreed upon whether the annual path would be used as a hard target (that is, a basis for evaluating Bank Indonesia's performance by the House) or just a projection (which is subject to various shocks).

CREDIT EXTENSIONS

Article 11 of Act No. 23/1999 stipulates that Bank Indonesia shall extend short-term financing facilities (FPJP) to banks. Under the amendment, new commentary was added to clarify that Bank Indonesia shall only provide a contingency financing facility (FPD) to banks encountering financial mismatches whereby systemic payment failure could take place and jeopardize the whole financial system. Under this new arrangement, the source of financing will be on the account of the government budget (APBN). In this regard, article 55 section 5 stipulates that Bank Indonesia is allowed to purchase government bonds with a view to extending the contingency financing facility. The settlement of systemic bank failures shall be regulated by a different Act, which would be enacted no later than the end of 2004. Before enactment of this act, the issue will be regulated under a Memorandum of Understanding between Bank Indonesia and the Government, to be finalized no later than February 2004 (the end of IBRA). Hence, if banks that are encountering financial difficulties (after using the intra-day liquidity facility and the short-term fund financing facility) are prone to systemic failures, Bank Indonesia may extend bridge-financing support to those banks. Concurrently, the government shall issue government bonds at a value equal to Bank Indonesia's bridging fund support, and Bank Indonesia could purchase those bonds in the primary market. These provisions are part of the implementation of the Financial Safety Net (FSN).

PURCHASE OF GOVERNMENT SECURITIES (SUN)

According to article 55 of the Act No. 23/1999, Bank Indonesia is forbidden to purchase SUN in the primary market. By contrast, according to this amendment act, Bank Indonesia is allowed to purchase short-term (no longer than 1-year) SUN in the primary market with a view to controlling the monetary aggregates. The medium- and long-term SUN can only be purchased in the secondary markets. These provisions are intended to ensure that the budget deficit is not financed by the central bank, which would undermine the inflation targeting framework.

BOARD OF SUPERVISION

Unlike article 38 of the Act No. 23/1999, the article of this draft amendment explicitly stipulates that in carrying out its duty, the Board of Governors' performance shall be evaluated by the House of Representatives. The quarterly and annual financial and economic reports submitted by Bank Indonesia shall be used by the House to assess the performance of the Board (article 58). Along with this public accountability principle, the draft amendment requires Bank Indonesia to comply with transparency principles mainly as regard its internal financial condition, the budget and its operational activities. This is clarified by additional commentary in article 58A, concerning the establishment of the Supervisory Board. The main task of the Supervisory Board is to assist the House in conducting its surveillance or its "check and balance" function on Bank Indonesia's accountability, independence, transparency and credibility. The surveillance function covers the assessment on (i) the Bank Indonesia annual financial report; (ii) Bank Indonesia's operational and investment budget; and (iii) decision-making processes other than those concerned with monetary policy and Bank Indonesia's asset management.

Members of this Supervisory Board are to be selected from among those who have high integrity and moral standards, and respected competency and professional qualifications in the fields of economics, finance, banking and law.

Box The White Paper

BACKGROUND

In accordance with recommendations of the People's Consultative Assembly (MPR), on July 23, 2003 the government decided not to extend its program with the IMF beyond its schedule termination at the end of 2003. In that connection, the Government on April 25, 2003 established a "Post-IMF Program Strategic Study Team," an interdepartmental team in cooperation with BI. As follow-up, on September 15, 2003, the Government issued Presidential Instruction (INPRES) No. 5 of 2003 on "A Package of Economic Policies Before And After Termination of the Cooperation Program with the International Monetary Fund." The program consists of 3 main pillars, namely: (i) a macro stabilization program, (ii) a restructuring and reform program for the financial sector, and (iii) an investment-, export- and employment-enhancement program.

This package of economic policies, often called the White Paper, was directed at overcoming obstacles to national development and preparing for greater challenges ahead, including steps to prevent a recurrence of the disastrous financial and banking crisis of 1997/98. The programs were prepared in the form of matrices itemizing policies that included macro economic stabilization, financial sector restructuring and reform, and the national payment system, complete with implementation schedules.

In line with the package, by way of coordination of measures with the government, Bank Indonesia on September 15, 2003 issued the Decree No. 5/13/KEP.GBI/2003 outlining the Macroeconomic Stabilization Program and Financial Sector Restructuring and Reform.

To meet principles of accountability and transparency, Bank Indonesia together with the government periodically (quarterly) publishes implementation of its action plan to the public. As of the end of December 2003, Bank Indonesia announced that several action plans had been completed. In general, the achievements demonstrate the strength of BI's commitment to these programs.

BANK INDONESIA PROGRAMS TO SUPPORT MACRO ECONOMIC STABILIZATION AND FINANCIAL SECTOR RESTRUCTURING AND REFORM

In the framework of supporting macroeconomic stability and development of a sound banking sector, Bank Indonesia prepared programs that were expected to increase economic growth and to create more employment opportunities. These programs covered Macroeconomic Stabilization and Financial Sector Restructuring and Reform.

The Macroeconomic Stabilization Program

The role of Bank Indonesia in supporting the Macroeconomic Stabilization Program is fully consistent with Bank Indonesia's objective of achieving and maintaining stability in the rupiah. To that end, in the implementation of monetary policy Bank Indonesia has established monetary and inflation rate targets. In this context, Bank Indonesia will reinforce its continuing efforts to achieve a low inflation rate, to maintain a realistic exchange rate, to maintain adequate foreign exchange reserves, and to maintain a safe and efficient national payment system.

To achieve a low rate of inflation in the medium-term, Bank Indonesia will enhance the efficacy of inflation control through optimization of monetary control using the instruments of Open Market Operations (OPT), sterilization/intervention in the foreign exchange market, and other monetary instruments. To support achieving low inflation, Bank Indonesia will attempt to accelerate the recovery of bank intermediation using moral suasion vis-à-vis the banks and step-up coordination with the government to prevent crowding out liquidity resulted from government bond issuance. BI will also prevent excessive monetary expansion due to drawdowns of government accounts with Bank Indonesia.

Meanwhile, in the framework of strengthening monetary control management, Bank Indonesia will enhance coordination with the government in management of the government's domestic and foreign debts, and in the development of infrastructure for the secondary market in state bonds (SUN). There would also be coordinated use of SUN and SBI as monetary instruments.

On the exchange rate side, Bank Indonesia will apply the policy of maintaining a realistic rupiah exchange rate through various regulations in the areas of banking and foreign currency intervention. Additionally, Bank Indonesia will improve the quality of information on foreign currency transactions, including monitoring of market players, and coordinate with government institutions and state-owned corporations that are the main players in foreign currency markets.

In connection therewith, Bank Indonesia will maintain adequate foreign currency reserves as measured by import requirements and government foreign debt repayments. In support, Bank Indonesia will continue to improve international cooperation in the framework of Bilateral Swap Arrangements (BSA) with Japan, China and South Korea and to coordinate with the government.

Efforts will continue to keep the National Payment System safe and efficient through improved risk management. The envisaged products include a clearance risk management system and payment system supervision.

Financial Reform and Restructuring Program

The financial reform and restructuring program covers three main activities, namely: (i) the Financial Safety Net and Financial System Stability, (ii) A Policy of Restructuring and Recovery of Banks in line with the 25 Basel Core Principles, and (iii) A Policy on the Management of Money Laundering Crime.

In connection with the financial safety net and financial system stability, the action plan covers finalization of the concept of a Financial Safety Net and a proposed draft amendment to Act No. 23/1999 on Bank Indonesia and the mechanism of a Lender of the Last Resort. In addition, to develop a stable financial system, Bank Indonesia will enhance the monitoring of related parties in the financial sector and its research on financial system stability. It will also prepare recommendations and gradually implement the Indonesian Banking Architecture (API). Banking policy will be further supplemented by the linkage program between commercial banks and BPRs, and the development of sharia banks.

Another initiative under the authority of Bank Indonesia is the policy on restructuring and recovery of banks in line with the 25 Basel Core Principles. This covers improvement of banking regulations and supervision; *enforcement* of special loan auditing followed by *prompt corrective actions*; and bank supervisor and auditor certification programs. Meanwhile, in the framework of handling money laundering crime, Bank Indonesia will continue to improve the Know-Your-Customer Principles for commercial banks, BPRs, and Money Changers in complying with the Act No. 15/2002 and FATF (Financial Action Task Force on Money Laundering) recommendations.

Progress Review

As of December 2003, Bank Indonesia was on-schedule with its action plan as contained in the White Paper. Twelve actions were already completed, with 2 reaching the final concept. Another 12 actions will be completed in 2004 according to the planned schedule. A further 20 actions are on-going and will be carried out on a routine basis.

The Macroeconomic Stabilization Program

Most of the achievements under "the Macroeconomic Stabilization Program" is on-going responsibility of Bank Indonesia that is in line with medium-to long-term monetary policy. Some financial indicators that are relevant in this regard are currently stable or under firm control. By way of examples, inflation was down to 5.06% by the end of December, 2003, way below a year previously when it stood at 10.03%; the rupiah exchange rate was relatively stable and tended to strengthen during 2003 (to Rp8,465 per dollar at end-2003 versus Rp8,950 at end-2002); and the 1-month SBI interest rate at end-2003 was 8.38% compared with 12.7% at end-2002.

Meanwhile, official foreign exchange reserves at end-2003 totaled $36.2 billion, equivalent to 7.1 months of imports and government foreign debt payment. In an effort to boost foreign exchange reserves, Bank Indonesia signed a *Bilateral Swap Arrangement* (BSA) with Japan, China, and South Korea in line with 2003 target. The swap facilities available by this means are in the amount of $5 billion.

Concerning the payment system, the policy of maintaining a safe and efficient national payment system was implemented through the action plan to improve risk management in the payment system. At present, some related provisions and infrastructure development are still in process. These have reached the respective stages of explaining the *Failure to Settle Arrangement* to the Forum for Communication of the National Payment System (FKSPN) and of preparing the concept of Bill on Fund Transfers.

Financial Reform and the Restructuring Program

Concerning the Financial Safety Net and Financial System Stability component through December 2003, the Government and the House of Representatives (with Bank Indonesia as information source) completed the Draft Amendment to Act No. 23 of 1999 on Bank Indonesia. This contains one fundamental, new point, namely the provision of the Indonesian Financial Safety Net (IFSN) which is to be covered in a separate Act no later than December 31, 2004. The IFSN covers the function of Bank Indonesia as the Lender of Last Resort (LOLR), which concerns an emergency financing facility. This facility is financing support that can be extended by BI to banks with the final burden of finance to be born by the Government.

To cover the period before the Act on IFSN is promulgated, the Government and Bank Indonesia are preparing a memorandum of understanding on the IFSN, which is scheduled to be completed by the end of February 2004. On other aspects of the financial safety net, a study is being conducted on phasing-out the Blanket Guarantee program, and the Bill on the Deposit Guarantee Institution (LPS) has been submitted by the Government to Parliament.

Bank Indonesia has also completed the concept, recommendations, follow-up action and final report on the **Indonesian Banking Architecture (API),** which was officially launched in January 2004. Moreover, in the context of developing sharia banks, Bank Indonesia has completed a study on capitalization, risk management, risk-based bank supervision and the management component in the evaluation of the soundness of sharia banks. The results of the study were presented to stakeholders of sharia banks on December 23, 2003 and will be used as the basis for preparation of related provisions in 2004.

Some provisions on banking recovery and restructuring policy in accordance with the Basel Core Principles have also been completed, covering *inter alia*: the guidelines on the application of risk management for banks; provisions on CAR that takes into account market risk; improvement of the provisions for fit and proper tests; guidelines for risk-based supervision; application of the Know-Your-Customer Principle for commercial banks and BPRs; and training on Risk-Based Supervision (RBS). Furthermore, Bank Indonesia continues to carry out prompt corrective actions (PCA) to assure banks' compliance with prudential regulations.

Looking ahead, Bank Indonesia will continue its task of finalizing the post-IMF national economic recovery program, in line with the time schedule established in close coordination with the government.

Box Inflation and the General Elections

The General Election (GE) is essentially a democratic celebration, whereby people's representatives are selected for the legislative body. Usually, political parties are competing with each other, offering various promising programs in order to attract more people as their constituents. For the ruling party, one of the success indicators is how to transform their promises into improved economic conditions.

The government stance in dealing with the GE has provoked the emergence of a Political Business Cycle Theory (Alt and Christal, 1983). This theory investigates how the phenomenon of a GE affects a country's business cycle. Does the phenomenon of a Political Business Cycle exist in Indonesia? If so, then this should affect the behavior of the business community in planning their business activities. For Bank Indonesia, this could have strong implications for achieving the inflation target.

Using Periodogram Analysis, this study attempts to analyze the impact of observable GE events on GDP growth and inflation cycles. The periodogram analysis is a cyclical measurement technique of a fixed-length cycle versus some economic variable. This technique is useful to investigate the existence of a political business cycle (Political Cycle Theory) [1]

DATA COVERAGE

During the New Order era, a GE was carried out every 5 years starting in 1971, followed by 1977, 1982, 1987, 1992 and1997. During the Reformation era, the first GE was conducted in 1999 and the second will be in 2004. The GE itself is usually held near mid-year; in this study, the GE base period is assumed to be July.

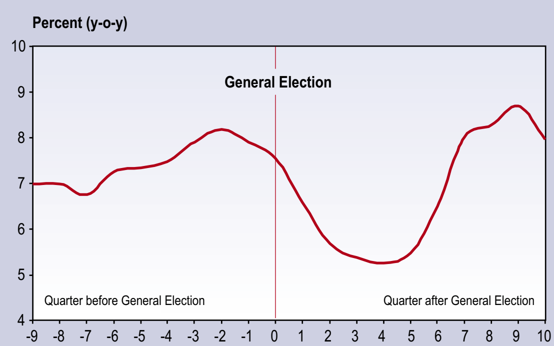
Concerning the available data, the Consumer Price Index (CPI) starts in 1975, whereas GDP starts in 1980. To provide greater comparability, the 1998-1999 data are disregarded because they concern the crisis period, which is considered exceptional.

GDP GROWTH PERIODOGRAM

The GDP growth periodogram for Indonesia shows no clear cycles related to the GE phenomenon. There are two cycles in one GE period with two peaks[2] at 2 quarters before the GE and 9 quarters after the GE, suggesting the absence of a political business cycle in GDP growth.

This result may be due to the government's lack of enthusiasm and/or inability in control short-term GDP growth, particularly in dealing with GEs. This is also closely related to the former (1970 up to 1998) practice of balanced budgets, which left little run for short-term fiscal stimulus. Also, the share of government expenditures in GDP was quite small

Chart 1.
GDP Growth Periodogram



1 Michael P Niemira & Philip A.Klein, Forecasting Financial and Economic Cycles, John Wiley & Sons, Inc, 1994, page 111.

2 A peak point in one cycle

(1997-2002 = 11.6%), providing only a small direct impact of government spending on overall GDP growth. Furthermore, even if the multiplier effect were quite large[3], the total impact on GDP would have a long lag.

INFLATION PERIODOGRAM

Unlike GDP growth, the inflation periodogram analysis for Indonesia indicates a clear cycle during the GE period. Chart 2 shows that inflation declines prior to a GE and for 3 quarters after the GE is over; then it tends to increase. This confirms the existence of political cycle in Indonesia wherein the government tries hard to control inflation in advance of the GE.

However, is it really true that the Government has control over inflation? The impact on inflation of various policies associated with a GE is discussed below.

By factors affecting inflation, control over administered prices, capacity to distribute goods and services, and exchange rate policy (particularly during 1997) are the most significant factors that can be controlled by the Government. The absence of a growth-based political cycle, noted earlier, argues against demand pressures on inflation.

3 Source : BPS, Indonesia Input-Output Table, Updated 1998, processed.

Chart 2.
Inflation Periodogram

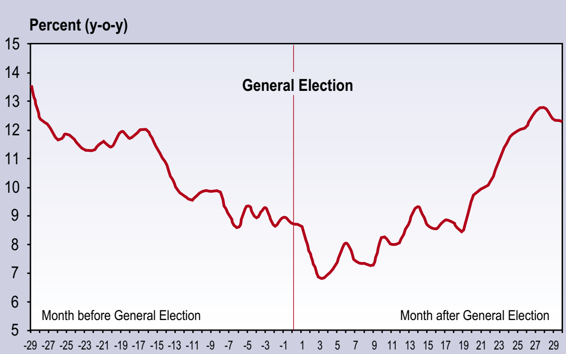
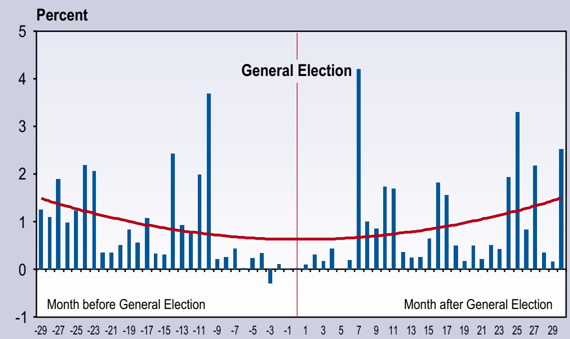


Chart 3.
Average Administered Goods Prices Changes Before and After General Election



1. The periodogram analysis shows that since 1990 a changing pattern in administered prices was closely correlated with the GE phenomenon. Administered price inflation has tended to decline before a GE and to increase afterwards (Chart 3). This indicates that the government was making efforts to control prices in relation to the GE.
2. Using the periodogram approach, efforts to control prices using supply management do not have any correlation with GE events, for instance, imports of foodstuff since 1988-2000 (Chart 4). If efforts were made to manage the supply of goods during GE events, growth in import volumes would tend to increase prior to GE

Chart 4.
Average Increase Food Imports Volume Before and After General Election

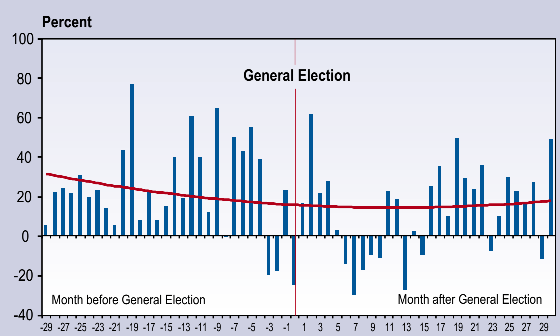
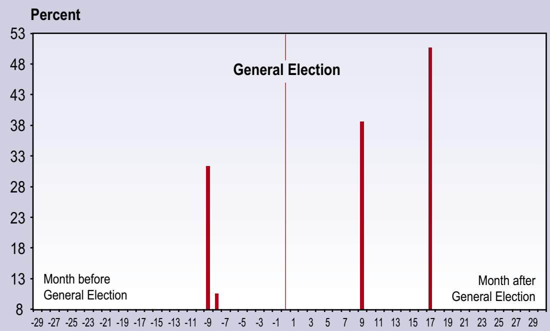


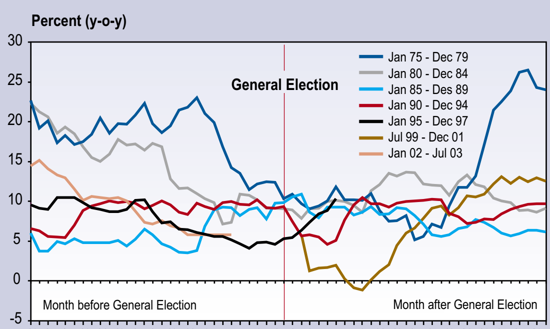
Chart 5.
Rupiah Devaluation Before and After General Election



periods. The evidence shows, however, there is no clear import volume pattern during several GE events.

3. Also, there is no clear pattern between the exchange rate and GE events during the 1975 – 1997 period (Chart 5). During this period, the government devaluated the rupiah three times. The September 1986 devaluation was 9 months prior to the July 1987 election, and analysis confirmed inflationary pressure during the GE period (Chart 6). By contrast, the November 1978 devaluation (17 months prior to the GE) and the March 1983 devaluation (9 months prior to the GE) appear to have generated inflationary pressures prior to the GEs.

Chart 6.
Inflation Development at Every Interval of General Election Period



Based on these indicators, the impact of political cycles on inflation is mainly driven by efforts to control administered prices. The two devaluations, just mentioned, did contribute to upward pattern of inflationary pressure aftermath the GEs. It is worth to note that the above analysis merely affirms government eagerness to reduce inflationary pressures in anticipation of the GE events, however, the bottom line is that the government has the capability to control prices through controlling the administered prices.

DEMOCRATICATION OF GENERAL ELECTIONS IN RELATION TO THE ECONOMIC CYCLE

The New Order Era

As commonly known, elections during the New Order era were characterized by one majority party supported by the ruling government, which effectively meant a non-democratic GE. One implication of these arrangements is the desire of the rulling party to attract more constituents by improving the macroeconomic variables. This was mainly seen in the development of GDP growth, which as noted earlier, have no clear relation to GEs. For its part, though there was correlation between inflation and GEs, it plainly marks an indication and it could occur by accident. Meanwhile, the policy to devaluate the rupiah, which has a strong pass through effect to inflation, did not seem to correlate with the GEs.

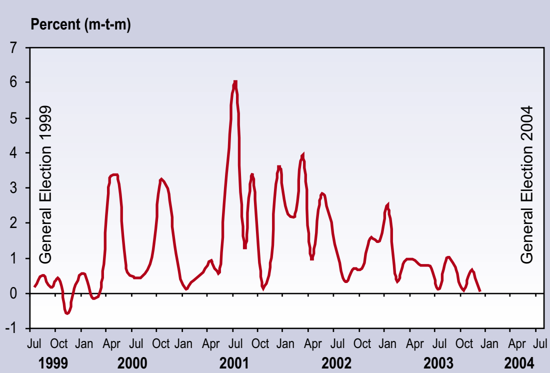
The Reformation Era

In contrast to the New Order Era, the GE process has been more democratic during the Reformation era. The implication of this phenomenon is that the incumbent party tends to maintain its power in various ways, including by controlling various macroeconomic variables in order to attract more constituents. Despite more available options during the reformation era, the efficacy of government policies is less,[4] and the inflationary impact of the political cycle is likely to be more significant through administered price management. Nevertheless, it is hard to find a close correlation between growth management and GE events.

The pattern of the political cycle could be clearly observed in administered prices, beginning with the first GE in the Reformation Era (July 1999) up to the current GE (July 2004). There was a rising trend in administered prices from July 1999 to April 2002 and a decline afterwards (Chart 7). The 2002 BI Annual Report stated that administered prices were predicted to increase significantly in 2003 and would make a 3% contribution to inflation. In the event, increases in various administered prices were postponed by the Government.[5] As a result, the impact of administered price increases was much less than expected, only about 0.9% on inflation[6]. These delayed administered price increases provide evidence of the political pressure on administered pricing policy.

The Potential for Administered Price Increases Afterward the 2004 GE.

Chart 7.
Administered Prices Development



If the Political Business Cycle Theory is applicable in Indonesia, the government will try to eliminate increases in administered prices before the 2004 GE. In parallel, there would be some catch-up in such prices after the 2004 GE. Also, control may be extended to other potential administered prices after the GE is over. For example:

1. The rise in telephone tariffs of around 15%, was to be implemented in early 2003. This constituted one part of the plan agreed by the Government and the House to raise telephone tariffs by 45.5% during 2002 – 2004, making for an average increase of 14% per year.
2. The increase in electricity tariffs (TDL). In 2003, the government delayed the fourth step of a TDL increase of 6%.
3. The plan to raise fuel prices as stated in the Propenas (Five Year National Development Plan). Fuel subsidies were to be removed in 2006 and, starting in 2005, privatization of fuel retail trading would be introduced. To this end, the determination of fuel prices was initiated with reference to the MOPS [Mean of Platts Singapore) using upper and lower price bounds. In the event, the MOPS system was not implemented in 2003. If the government had implemented this plan in accordance with the Propenas, fuel prices would have increased significantly (particularly for kerosene and diesel), knowing that these two prices were 50% and 75% less than market-determined prices. Futhermore, if the privatization of retail sales for fuel had been applied, retailers would have

4 For example, a state budget dominated by huge debt and interest payments.
5 Such as delayed price increase of fuels, electricity and excise on cigarettes.
6 Mainly from the increase in electricity base tariff.

added a wider margin on the base price (100% of MOPS).

4. Higher retail prices for cigarettes (HJE). In the last four years (except for 2003), HJE constantly increased and contributed significantly to inflation.[7] The purpose of raising HJE was to hit targets for excise revenues set by the budget. Looking ahead, higher HJE is probably in store, because the excise on cigarettes is still low (25% less) in Indonesia relative to other developed countries (up to 75%).

CLOSING

The analysis shows that growth rates in GDP in Indonesia do not exhibit a political cycle. By contrast, inflation rates are related to GEs. The politically-based inflation cycle is strongly correlated with administered price management related to GEs.

During the Reformation Era, the GE process has become more democratic, which raises the significance for inflation of the political cycle in Indonesia. Consequently, inflationary pressures driven by various government pricing policies are predicted to rise after the 2004 GE, following delays in 2003.

Based on this analysis, it is expected that inflationary pressures will build mainly in 2005 and 2006. This will hinder Bank Indonesia's target of a declining medium-term inflation path, which is crucial in lowering inflationary expectations and re-enforcing efforts to achieve the inflation target. On this basis, a longer period is required to enable Bank Indonesia to achieve a low and stable inflation rate. Moreover, to achieve low inflation, mutual commitments between Bank Indonesia and the Government are vital.

7 In 2000, 0.71%; in 2001, 1.24%; and in 2002, 0.58%.

Box The Investor Information and Enquiries (IIE) Website: A Main Facility in the Investor Relations Unit (IRU)

Weak economic fundamentals in mid-1997 resulted in the financial and banking crisis. This was marked by an unstable exchange rate and low international market confidence in the Indonesian banking system and economic prospects, which in turn led to large capital outflows and disrupted international trade. Such conditions were magnified by unreliable information that amplified volatility of the rupiah exchange rate.

Similar crisis experienced by other developing countries (such as Mexico, Turkey and the Philippines) indicated that the crisis impact was generally aggravated by negative sentiment in financial markets. This often occured due to ineffective dissemination of information, which heightened the pessimism of market players.

Despite having a free foreign exchange regime that depends heavily on international capital markets, Indonesia does not yet have a source of official information for investors and international rating institutions. To rectify this, it will be important that Indonesia design an investor relation program that would enable continuous, intensive communications with investors and rating agencies in order to maintain positive market perceptions.

Investor Relations is management of information on finance, marketing and strategies between a country/company with investors in order to build up confidence within the capital market. The effectiveness of investor relations will be reflected in a country's success in building a positive image and improving market assessments, to reduce the country's cost of borrowing.

The benefits of investor relations include:

1. Avoiding shocks and preventing crisis by assisting the government in influencing market sentiment by comprehensive, accurate information forwarded to market participants.
2. Gaining response from the market regarding desirable policy changes to assist the government.

As a media of communication, there are two main functions of investor relations:

1. The Speaking Part

Proactively delivering favorable information on the country's economic conditions. The speaking part is easier than the listening part (see immediately below) because the speaking part is only concerned with delivering information to the market.

2. The Listening Part

Listening to input from the market for the purposes of appropriate policy change. The listening part is more difficult because, based on these inputs and feedback, recommendations should be made to the government for coherent policy reform.

In implementing the function of investor relations, several instruments are widely used, namely: (1) an Investor List; (2) Mass Distribution; (3) a Website; (4) Teleconferences; (5) Road Shows; (6) Press Relations; and (7) One-on-One Meetings.

The function of investor relations in a country may be delegated to a separate institution (an Investor Relations Unit, IRU) or to a unit under an existing institution. In this case, Bank Indonesia has taken the initiative to establish an IRU, based on the following considerations:

a. Bank Indonesia already has an Investor Information and Enquiries (IIE) website that provides information needed by investors and international rating institutions.
b. The existing information technology in Bank Indonesia supports IRU implementation.
c. Bank Indonesia is the main source of data and information to be delivered by the IRU, namely data and information on economic conditions, and money and banking.

In establishing the IRU in Indonesia, there are various supporting and constraining factors. The supporting factors include the IIE website that has been in operation since August 14th, 2002; the external and internal dedicated team that has been established to update all information presented in the IIE website; roadshows and teleconferences have been implemented by the government; and the human resources managing the website of IIE are in place.

Development of an IRU in Indonesia also faces constraint. Although some relevant institutions at the technical level have participated in updating information on the IIE website, agreement and commitment from senior officials of relevant institutions remains uncertain. Strong support and commitment from senior officials of relevant institutions (such as the Finance Ministry, the State Minister for State-Owned Corporations, the Capital Investment Coordinating Board and the Ministry of Industry and Trade) are crucial to ensuring the accuracy and timeliness of information delivered by IRU. Another constraint is that the function of listening part, namely, policy-making based on inputs from the public has not been effective to date.

Establishment of IRU Indonesia was undertaken in 2003 and it is expected to be completed by 2005. The activities to be performed in each phase are as follows:

Phase I (2003)

a. Drafting the TOR of IRU as a reference for the up-coming phases of IRU.
b. Socialization of the IRU to the technical level in relevant institutions.

Phase II (2004)

a. Preparing the IIE website to become the IRU website. This includes improving the substance of information.
b. Performing socialization to decision-makers and studying the relationship with the Institute of International Finance (IIF) in order to assist with establishment of the IRU.
c. Developing an investor list. Development of this database was started in the third quarter of 2003.
d. Conducting roadshows and teleconferences regularly. And,
e. Preparing the organizational structure of IRU.

Phase III (2005)

Activities would be focused on introducing IRU Indonesia to investors, rating institutions and potential creditors. There would also be an official declaration on the organization and an IRU launching.

Box Impact on Indonesia from China's Entry into the WTO

The rapid development of the Chinese economy in the last few years was very impressive, averaging 7% in annual growth. Along with the slow down in major world economies during the last few years, this impressive growth has promoted China's role in the global economy. Even so in Asia, China has become one of the strong economy after Japan. This is inherent with the Chinese successful implementation of economic reforms gearing towards a market oriented economy. Additionally, the success was intensified along with China's entry into the WTO since 2000.

The China's entry into the WTO has made the Chinese economy to be more opened mainly in trading and investments. From the trading side, along with the growing opened trading opportunities with WTO member countries and supported by a well-prepared business sector, the China's international trade is showing an upward trend (Chart 1), mainly in the Asian region as the biggest share of China's export products (Chart 2).[1] This was made possible largely due to improved competitiveness of Chinese products supported by cheap labor cost and stable exchange rate.

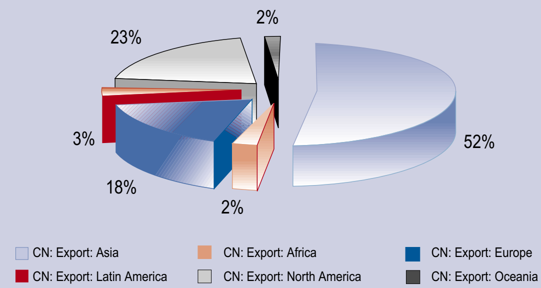


Chart 2
Share of China's Export 2002

The increasing China's trade volume gives rise to challenges and opportunities to Indonesia a well. The bilateral trade between Indonesia and China kept increasing despite its small share. During the period of 1984-2002 the share of China's exports to Indonesia on average is only 0.7% from its total exports, whereas China's imports from Indonesia is on average 1.5% from its total imports (Chart 3). By view of bilateral trading between these two countries, Indonesia always enjoys a surplus (Table 1).

1 In 2003 the SARS epidemic swept over the Asian region was mainly found in China and disrupted the China's export performance.

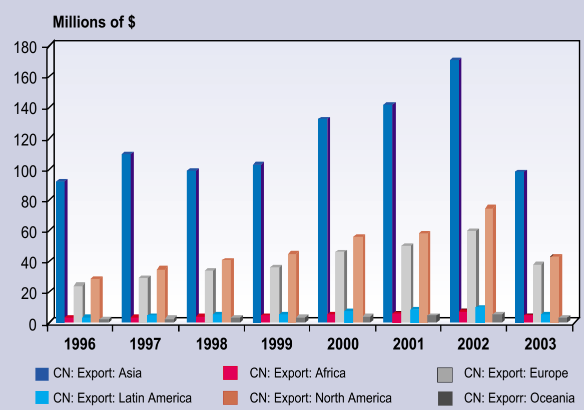


Chart 1
Growth of China's Export Value

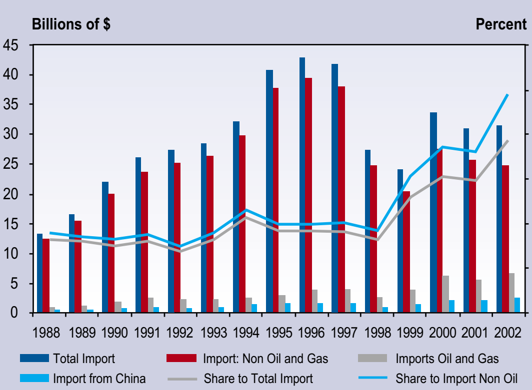


Chart 3
Share of Indonesia's Import from China

Table 1
Indonesia and China Bilateral Trade

Millions of $

Year	Indonesia's Import from China	Indonesia's Export to China	X - M Net
1993	693	1,446	753
1994	1,052	1,589	538
1995	1,438	2,053	615
1996	1,428	2,289	860
1997	1,844	2,674	830
1998	1,172	2,462	1,290
1999	1,779	3,051	1,272
2000	3,061	4,402	1,341
2001	2,847	3,888	1,041
2002	3,427	4,501	1,074

By commodity, since 1988 China's exports have shifted from primary goods (mining products) to products of middle and high end technology. By type of products, exported goods between Indonesia and China could be classified into substitution and complementary goods to each others. The complementary goods are expected to increase along with the rise in China's trading volume. The substitution goods, however, is likely to face great challenges from Chinese competing products (Table 2). In turn, this would hamper developments in small and medium business sectors in Indonesia, mainly for manufacturing using low technology.

Against the promising opportunities, the China's economy constitutes a potential market for global investors to invest. This is also supported by China's huge product markets, conducive labor market condition, and a more liberal economic policies. This in turn has increased the challenge to the Indonesia's economy as regards the relocation of several manufacturing industries out of Indonesia. Nonetheless, the rapid growth in China's economy implies improved capability of Chinese investors to invest abroad. Hence, implying opportunities for Indonesia as well.

Table 2
Major Export Commodities Indonesia and China

Ranking	Indonesia Export Commodities (Top 10)	Export Value (Millions of $)		China Export Commodities (Top 10)	Export Value (10 Millions of $)	
		2001	2002		2001	2002
1	Mineral Fuels.Lubricants etc.	97.513	86.144	Manufactures	240.185	297.171
2	Manufactured Goods	72.693	70.518	Machinery and Transport Equipment (MTE)	95.098	127.008
3	Miscellaneous Manufactured Articles	62.782	62.923	Miscellaneous Manufactured Articles (MMA)	87.206	101.197
4	Machinery and Transport Equipments	62.142	54.875	Manufactured Goods Chiefly by Materials (MG)	43.878	52.980
5	Petroleum and Petroleum Products	48.065	40.708	Primary Products	26.476	28.472
6	Gas. Natural and Manufactured	39.472	34.486	Textile Yarn. Fabrics. Madeup Articles. nes & Related	16.840	20.571
7	Crude Materials. Inedible	28.843	26.732	Chemicals and Related Products (CRP)	13.458	15.336
8	Textile Yarns. Fabrics and Madeup Articles	21.241	22.943	Food and Live Animals Chiefly For Food (FLA)	12.794	14.630
9	Food and Live Animals	20.865	19.027	Mineral Fuels. Lubricants and Related Materials (MFLM)	8.506	8.359
10	Wood and Cork Manufactures	19.200	18.960	Non Metallic Mineral Manufactures	4.854	6.148

Appendices

Appendix A

BANK INDONESIA

Head Office

Jakarta

Representative Offices

London
New York
Singapore
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

Board of Governors of Bank Indonesia

As of December 31, 2003

Governor

Burhanuddin Abdullah

Senior Deputy Governor

Anwar Nasution

Deputy Governors

Aulia Pohan

Bun Bunan E.J. Hutapea

Maulana Ibrahim

Maman H. Somantri

Aslim Tadjuddin

Hartadi A. Sarwono

Appendix C.1

Organization and Human Resources

During 2003 Bank Indonesia made several improvements in view of its organization and human resources development aspects. Improvements in the organizational aspect were to meet the internal and external needs for Bank Indonesia's development and to support the realization of Bank Indonesia's mission. In order to enhance the efficiency of Bank Indonesia's assets management, an Asset Settlement Bureau as a part of the Directorate of Internal Financial Management was established.

In the Payment System area, improvements in the organizational aspect were made to support efficient monitoring and controlling cost of currency in circulation, to clarify responsibilities in conducting currency distribution plan, to improve surveillance on companies distributing small cash exchanges around Jabotabek region, and to optimize the dissemination of data information as decision making tool on currency circulation.

To disseminate information on Bank Indonesia's history, as a Central Bank as well as to maintain Bank Indonesia's heritage such as old buildings and historical treasure collections, a task force is established to facilitate the educative information for the public. To this end, a Special Unit of Bank Indonesia Museum was established to design a Bank Indonesia Museum that is managed professionally.

To maintain financial system stability through research activities on financial system surveillance framework, a Financial System Stability Bureau was established under the Directorate of Banking Research and Regulation. This bureau was put in place as a realization of Transformation Program on Banking Workstream project.

Along with rapid development of the Sharia Banking industry, an integrated sharia banks licensing and supervision unit is needed. To this end, the status of the Sharia Banking Bureau was upgraded into Sharia Banking Directorate.

In line with the growing importance of qualified information technology in view of Bank Indonesia's internal and external development, efforts were made to improve the function of Information Technology Directorate as part of the Transformation Program of IT workstream.

In the conduct of monetary policy, Bank Indonesia continued to improve coordination among high ranking officials within Bank Indonesia through the establishment of Monetary Policy Review Committee (KEM). This KEM constitutes a means of coordination and exchange views among Directorates and Bureaus within the monetary sector and the Directorate of Banking Research and Regulation in preparing recommendation of strategic issues proposed to the Bank Indonesian Board Meeting.

As regard to internal structural transformation within Bank Indonesia, the BI Transformation Program was continued through the implementation of several strategic projects such as: the Corporate Culture Project; the Risk Management Project and the Regional Office Revitalization Project. The implementation of each project is organized under the Special Unit for Transformation Program, as a follow up of previous diagnostic study.

To produce highly motivated human resources with strategic values in view of achieving Bank Indonesia's mission, a Project on the Improvement of Human Resources Management System was conducted. This project was designed to produce human resource management policies, regulations on promotion, recruitment, training and education, and carrier plan.

As regard to the development of competent-based human resource management, efforts were made to improve success profile of Bank Indonesia's officials. The first part of this project was done to cover officials with ranking VI, VII, and VIII, followed by the second part covering the sub-ordinate ranking. In addition, a blue print of Human Resource Information System (SIMASDAM) was completed and will be followed up by its application according to the improvement of Human Resource Management System

Number of Personnel

No.	Year	Head Office	Regional Offices	Representatives 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.	January 2002	3,119	2,556	18	5,693
6.	January 2003	2,971	2,480	14	5,465

1) Including those studying abroad

Head Office

Directorate of Economic Research and Monetary Policy	:	Halim Alamsyah
Directorate of Economic and Monetary Statistics	:	Tarmiden Sitorus
Directorate of Monetary Management	:	Budi Mulya
Directorate of Reserve Management	:	Made Sukada
Directorate of International Affairs	:	Ny. Kusumaningtuty
Bureau of Credit	:	Ny. Ratna E. Amiaty
Directorate of Banking Research and Regulation	:	Nelson Tampubolon
Directorate of Bank Licensing and Banking Information	:	Ny. Siti Ch. Fadjrijah S.
Directorate of Bank Supervision 1	:	S. Anton Tarihoran
Directorate of Bank Examination 1	:	Yang Ahmad Rizal
Directorate of Bank Supervision 2	:	Aris Anwari
Directorate of Bank Examination 2	:	Ridwan Masui
Directorate of Rural Bank Supervision	:	Syahrul Bahroen
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	:	Ardhayadi
Directorate of Legal Affairs	:	Roswita Roza
Directorate of Internal Audit	:	Djoko Sutrisno
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	:	Perry Warjiyo
Directorate of Islamic Banking	:	Harisman
Special Unit For Transformation Program	:	Romeo Rissal
Special Unit For Information Management	:	Dibyo Raharjo
Special Unit For Bank Indonesia Museum	:	M. Ashadhi

Representative Offices

Singapore	:	Ilham Ikhsan
Tokyo	:	S. Budi Rochadi
London	:	Rasmo Samiun
New York	:	Maman Hendarman

Regional Offices

Category I

Bandung	:	Irman Djaja Dalimi
Medan	:	Hadi Hassim
Semarang	:	Bachri Ansjori
Surabaya	:	Nana Supriana

Category II

Bandar Lampung	:	Endoong Abdul Gani
Banjarmasin	:	M. Zaeni Aboe Amin
Denpasar	:	Lukman Boenjamin
Manado	:	Abd. Kadir Masyhuri
Padang	:	M. Djaelani Soegiarto
Palembang	:	Erman Suherman
Makassar	:	Imrandani
Yogyakarta	:	Amril Arief

Category III

Ambon	:	Rachman Abdulkadir
Banda Aceh	:	Yusmanazir Katin
Cirebon	:	Tjahjo Oetomo K.
Jambi	:	Erman Kurnandi
Jayapura	:	Budiman Usman
Malang	:	Sentot Purnomo
Mataram	:	Wiyono
Pekanbaru	:	Mahmud
Pontianak	:	Rusli Sembiring
Samarinda	:	Prabowo
Solo	:	Adiastopo Joko Purnomo

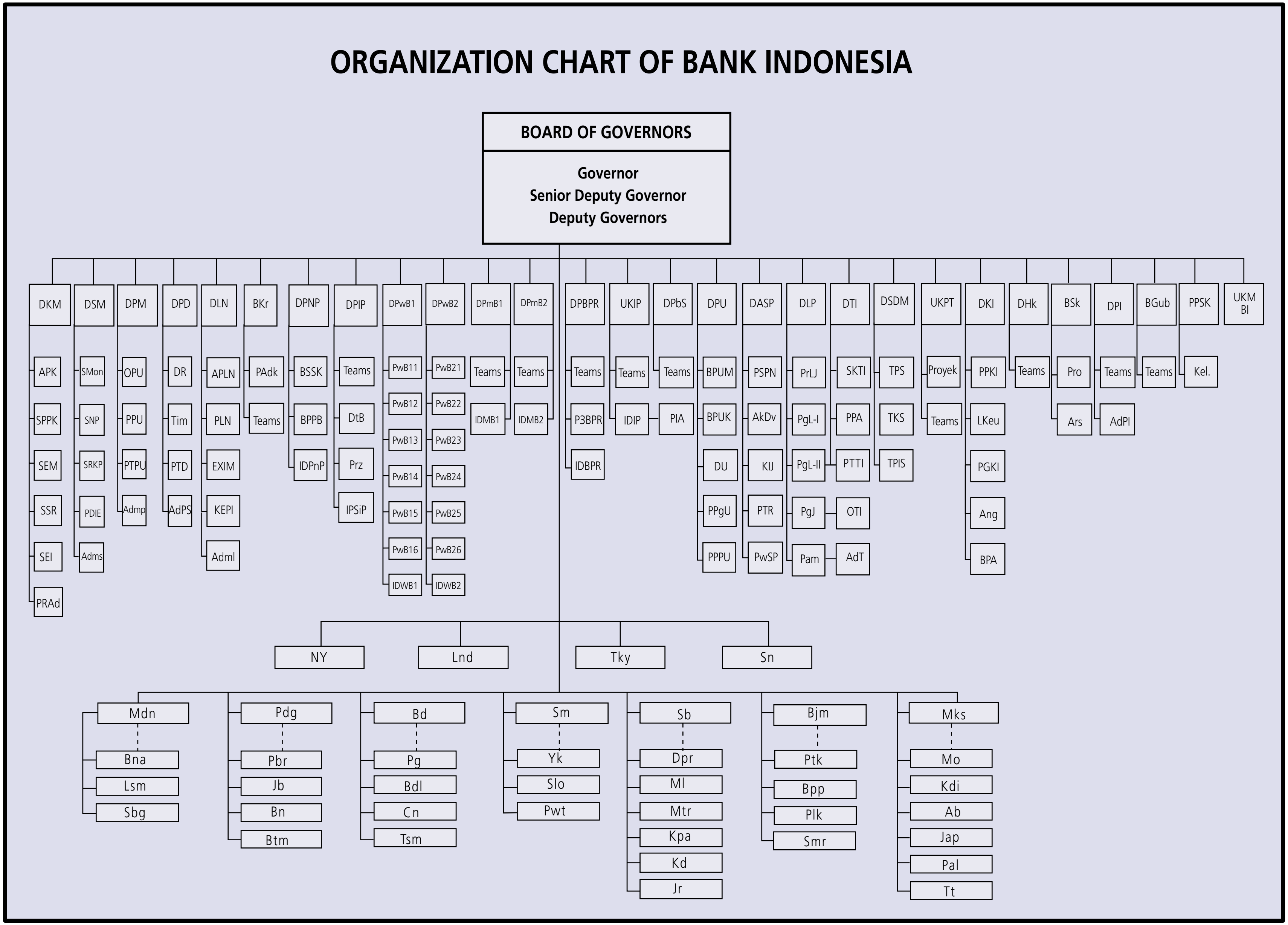
Category IV

Balikpapan	:	Matsisno
Kupang	:	Dikan
Jember	:	Sutikno
Kediri	:	Imbang Setiamihardja
Purwokerto	:	Mochtari
Tasikmalaya	:	Moch. Zaenal Alim
Palangkaraya	:	Bramono Sidik
Bengkulu	:	Joko Wardoyo
Kendari	:	Sarwanto
Palu	:	J. Wiwoho

Category V

Batam	:	I Made Sudja
Sibolga	:	Binsar Hutabarat
Lhokseumawe	:	Erdi Ali
Ternate	:	Muh. Abdul Fadlil

Appendix C.2



ORGANIZATION CHART OF BANK INDONESIA
BOARD OF GOVERNORS
Governor
Senior Deputy Governor
Deputy Governors
DKM
APK
SPPK
SEM
SSR
SEI
PRAd
DSM
SMon
SNP
SRKP
PDIE
Adms
DPM
OPU
PPU
PTPU
Admp
DPD
DR
Tim
PTD
AdPS
DLN
APLN
PLN
EXIM
KEPI
Adml
BKr
PAdk
Teams
DPNP
BSSK
BPPB
IDPnP
DPIP
Teams
DtB
Prz
IPSiP
DPwB1
PwB11
PwB12
PwB13
PwB14
PwB15
PwB16
IDWB1
DPwB2
PwB21
PwB22
PwB23
PwB24
PwB25
PwB26
IDWB2
DPmB1
Teams
IDMB1
DPmB2
Teams
IDMB2
DPBPR
Teams
P3BPR
IDBPR
UKIP
Teams
IDIP
DPbS
Teams
PIA
DPU
BPUM
BPUK
DU
PPgU
PPPU
DASP
PSPN
AkDv
KIJ
PTR
PwSP
DLP
PrLJ
PgL-I
PgL-II
PgJ
Pam
DTI
SKTI
PPA
PTTI
OTI
AdT
DSDM
TPS
TKS
TPIS
UKPT
Proyek
Teams
DKI
PPKI
LKeu
PGKI
Ang
BPA
DHk
Teams
BSk
Pro
Ars
DPI
Teams
AdPI
BGub
Teams
PPSK
Kel.
UKM BI
NY
Lnd
Tky
Sn
Mdn
Bna
Lsm
Sbg
Pdg
Pbr
Jb
Bn
Btm
Bd
Pg
Bdl
Cn
Tsm
Sm
Yk
Slo
Pwt
Sb
Dpr
Ml
Mtr
Kpa
Kd
Jr
Bjm
Ptk
Bpp
Plk
Smr
Mks
Mo
Kdi
Ab
Jap
Pal
Tt

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. Securities Settlement 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 RegulationTeam	-
	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	-
	2. Research and Development Team	PAdk
VII.	**DIRECTORATE OF BANKING RESEARCH AND REGULATION**	**DPNP**
	1. Financial System Stability Bureau	BSSK
	2. Banking Research dan Regulation Bureau	BPPB
	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	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 BANKEXAMINATION 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.	**DIRECTORATE OF ISLAMIC BANKING**	**DPbS**
	1 Teams	–
	a. Islamic Banking Research and Development Team	
	b. Islamic Bank Regulation Team	
	c. Islamic Bank Supervision Team	
	2. Islamic Banking Licensing, Information, and Administration Division	PIA

No.	Directorates and Divisions	Abbreviations
XVI.	**DIRECTORATE OF CURRENCY CIRCULATION**	**DPU**
	1. Cash Deposit Division	BPUM
	2. Cash Withdrawal Division	BPUK
	3. Currency Distribution Division	DU
	4. Currency Procurement Division	PPgu
	5. Currency Circulation Research and Development Division	P3U
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	KlJ
	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 Strategy and Policy Team	SKTI
	2. Information Technology Development and Maintenance Division	PPA
	3. Information Technology Technical Executing Team	PTTI
	4. Information Technology Operational Team	OTI
	5. Information Technology Administration 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
	5. Asset Settlement Bureau	PA
XXII.	**DIRECTORATE OF LEGAL AFFAIRS**	**DHk**
	1. Legal Advisor Team	
	2. Legal Information and Documentation Team	
	3. Enquiry Point Team	
XXIII	**DIRECTORATE OF INTERNAL AUDIT**	**DPI**
	1. Teams	
	a. Internal Audit Development Team	
	b. Regulation Analysis Team	
	c. Audit Teams	

No.	Directorates and Divisions	Abbreviations
	2. Administration and Information Division of Internal Audit	AdPI
XXIV	**CENTER OF EDUCATION AND CENTRAL BANKING STUDIES**	**PPSK**
	1. Researchers’ Group	-
XXV	**SPECIAL UNIT FOR TRANSFORMATION PROGRAM**	**UKPT**
	1. Projects	-
	2. Program Office Team	
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 Divison	Pro
	2. Archives Division	Ars
XXIX	**SPECIAL UNIT FOR BANK INDONESIA MUSEUM**	**UKMBI**
	1. Teams	
	a. History Team	
	b. Public Program Team	
	2. Administration Section	

No.	Branch Offices and Representative Offices	Abbreviations
I.	**Representative Offices**	
	1. New York	NY
	2. London	Lnd
	3. Tokyo	Tky
	4. Singapore	Sn
II.	**Regional 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, 2003 and 2002[1)]
(In Million Rupiah)

Assets	2003 *Unaudited*	2002 *Audited*
1. Gold	**10,945,736**	**9,505,929**
2. Foreign Currencies	**12,970**	**13,770**
3. Special Drawing Rights	**31,234**	**169,207**
4. Demand Deposits	**1,288,205**	**4,879,554**
4.1 Central Bank	362,174	3,352,163
4.2 Correspondent Bank	926,031	1,527,391
5. Time Deposits	**56,822,693**	**53,833,317**
6. Marketable Securities	**251,911,412**	**225,056,498**
6.1 In Rupiah	0	0
6.2 In Foreign Currency	251,911,412	225,056,498
7. Claims	**320,667,970**	**377,223,643**
7.1 On Government	**296,338,806**	**351,275,336**
7.1.1 In Rupiah	296,314,109	351,249,254
7.1.2 In Foreign Currency	24,697	26,082
7.2 On Bank	**15,223,666**	**17,942,326**
7.2.1 In Rupiah	14,220,108	16,882,455
7.2.2 In Foreign Currency	1,003,558	1,059,871
7.3 On Others	**9,105,498**	**8,005,981**
7.3.1 In Rupiah	9,105,498	8,005,981
7.3.2 In Foreign Currency	0	0
8. Allowance for Bad Debts	**(51,248,050)**	**(48,399,906)**
9. Equity Participation	**756,556**	**229,474**
10. Other Assets	**8,828,088**	**9,424,169**
TOTAL ASSETS	600,016,814	631,935,655

Liabilities and Equities	2003 *Unaudited*	2002 *Audited*
A. LIABILITIES		
1. Currency in Circulation	**112,746,176**	**98,395,190**
2. Demand Deposits	**227,488,010**	**229,231,098**
2.1 Government	**77,901,824**	**103,332,091**
2.1.1 In Rupiah	40,580,792	61,813,103
2.1.2 In Foreign Currency	37,321,032	41,518,988
2.2 Bank	**61,128,963**	**44,983,701**
2.2.1 In Rupiah	53,538,271	38,326,357
2.2.2 In Foreign Currency	7,590,692	6,657,344
2.3 Private Sectors	**712,803**	**924,774**
2.3.1 In Rupiah	687,421	795,363
2.3.2 In Foreign Currency	25,382	129,411
2.4 International Financial Istitution	**87,744,420**	**79,990,532**
2.4.1 In Rupiah	87,744,420	79,990,532
2.4.2 In Foreign Currency	0	0
3. Bank Indonesia Certificate	**135,929,228**	**112,795,991**
3.1 In Rupiah	135,929,228	112,795,991
3.2 In Foreign Currency	0	0
4. Loans from Government	**2,445,078**	**34,311,039**
4.1 In Rupiah	235,684	261,792
4.2 In Foreign Currency	2,209,394	2,322,720
4.3 Bank Indonesia Bond	0	31,726,527
5. Foreign Borrowings	**16,167,431**	**16,972,012**
6. Other Liabilities	**14,277,408**	**6,282,275**
TOTAL LIABILITIES	509,053,331	497,987,605
B. EQUITIES		
1. Capital	2,948,029	2,948,029
2. General Reserves	22,581,342	20,584,751
3. Statutory Reserves	9,677,671	8,822,036
4. Fixed Assets Revaluation Reserves	4,662,859	4,865,933
5. Exchange Rate & Foreign Security Revaluation Reserves	17,727,744	24,969,454
6. Government Bond Indexation Reserves	31,212,360	75,334,511
7. Bank Indonesia Bond Indexation Reserves	0	(6,428,782)
8. Previous Year Surplus (Deficit)	0	0
9. Current Year Surplus (Deficit)	2,153,478	2,852,118
TOTAL EQUITIES	90,963,483	133,948,050
TOTAL LIABILITIES AND EQUITIES	600,016,814	631,935,655

1) a. The Financial Report of Bank Indonesia in 2002 has been audited by the Supreme Audit Authority according to report No.01/01/Auditama II/GA/V/2003, May 12, 2003 with qualified opinion on claim account due to Bank Indonesia Liquidity Support (BLBI)
b. The Comprehensive Financial Report of Bank Indonesia in 2003 was submitted to Supreme Audit Authority through the letter No.5/1/GBI/DKI, dated February 3, 2003 to be audited.
c. Bank Indonesia Dollar/Rupiah Rate as of December 31, 2003: \$1 = Rp8,465,00 and as of December 31, 2002: \$1 = Rp8,940.00

Appendix D.2

Bank Indonesia
Surplus Deficit Statement
For the Years Ended December 31, 2003 and 2002
(In Million Rupiah)

	2003 *Unaudited*	2002 *Audited*
REVENUES		
1. Monetary Operations	**18,169,651**	**32,224,784**
1.1. Foreign Reserve Management	10,957,998	22,861,847
1.2. Money Market Activities	6,686	3,880
1.3. Credit and Financing	7,204,967	9,359,057
2. Payment System Services	**98,159**	**58,455**
3. Banking Services	**10,848**	**24,743**
4. Others	**111,860**	**800,235**
4.1. Other Revenues	111,860	92,625
4.2. Allowance for Bad Debt Recovery	-	707,610
TOTAL REVENUES	**18,390,518**	**33,108,217**
EXPENSES		
1. Monetary Operations	**17,920,918**	**26,867,476**
1.1. Formulating and Implementing Monetary Policy	14,360,825	18,379,704
1.2. Foreign Reserve Management	3,560,093	8,487,772
2. Payment System Services	**1,347,304**	**1,060,137**
2.1. Currency Circulation	1,202,490	1,013,810
2.2. Payment System Sponsoring	144,814	46,327
3. Banking Services	**269,479**	**69,768**
4. General, Administration and Others	**5,344,652**	**2,258,718**
4.1. Fixed Asset Depreciation	191,462	153,495
4.2. Intagible Asset Amortization	2,542	2,542
4.3. Additional Allowance for Bad Debts	2,986,437	-
4.4. General, Administration and Others	2,164,211	2,102,681
TOTAL EXPENSES	**24,882,353**	**30,256,099**
Surplus (Deficit) Before Extraordinary Items	**(6,491,835)**	**2,852,118**
EXTRAORDINARY ITEMS		
1. Extraordinary Revenues	25,297,744	-
2. Extraordinaty Expenses	16,652,431	-
TOTAL EXTRAORDINARY ITEMS	**8,645,313**	**-**
SURPLUS (DEFICIT)	**2,153,478**	**2,852,118**

Appendix E.1

List of Bank Indonesia Regulations in 2003

No.	PBI Number	Title	State Gazette	Description
1.	No.5/1/PBI/2003 dated 31-01-2003	THE AMENDMENT OF BANK INDONESIA REGULATION NO. 4/2/PBI/200 CONCERNING MONITORING ON FOREIGN EXCHANGE FLOW ACTIVITIES CONDUCTED BY NON FINANCIAL INSTITUTION COMPANIES	LN Year 2003 No. 14	This Bank Indonesia Regulation (PBI) amends the provision stipulated in Article 11 of PBI No. 4/2/PBI/2002 concerning the effective date of sanctions imposed on violation to submit a report on foreign exchange flow activities. This regulation is to be effective on January 2004. The sanction is stipulated in Article 7, Article 8, Article 9, and Article 10 of PBI No. 4/2/PBI/2002.
2.	No.5/2/PBI/2003 dated 03-02-2003	MONEY CHANGER	LN Year 2003 No. 12 TLN No. 4260	To regulate money changer (PVA) business according to prudential principles. This new regulation contains more detail descriptions on PVA business activities as compared to the previous Decree of the BI-Board of Directors (Keputusan Direksi Bank Indonesia / SK Dir BI) No. 31/171/KEP/DIR dated 17 December 1998. It includes: prohibiting PVA to conduct margin trading, requirements to establish PVA business for banks and non-banks, PVA supervision and reporting, and violation sactions.
3.	No.5/3/PBI/2003 dated 04-02-2003	THE SHORT TERM FINANCING FACILITY FOR BANK SYARIAH *(FPJPS)*	LN Year 2003 No. 13 TLN No. 4261	To regulate financing facilities extended to Sharia Banks experiencing a short-term financial mismatch. It includes: terms and conditions, and procedures to propose the financing facilities; the reward, repayments and execution of collateral.

No.	PBI Number	Title	State Gazette	Description
4.	No.5/4/PBI/2003 dated 21-03-2003	THE ISSUANCE, SALE AND PURCHASE, AND ADMINISTRATION OF GOVERNMENT SECURITIES	LN Year 2003 No. 38 TLNNo. 4278	Along with the Decree of the Minister of Finance No.66/KMK.01/2003 dated 10 February 2003 concerning the appointment of Bank Indonesia as auctioneer agent for Government Securities *(Surat Utang Negara / SUN)* in the primary market, this PBI was issued to enable Bank Indonesia to administer SUN and to purchase/to sell SUN in the secondary market. This PBI is aimed at ensuring an efficient, effective, accurate and accountable secondary market auction mechanism.
5.	No.5/5/PBI/2003 dated 01-04-2003	RUPIAH AND FOREIGN EXCHANGE MONEY MARKET BROKERAGE COMPANIES	LN Thn. 2003 No. 44 TLN No. 4283	This PBI regulates brokerage transactions in the money market, including SUN trading activities, licensing, supervision, reporting and sanctions.
6.	No.5/6/PBI/2003 dated 02-05-2003	LOCAL LETTER OF CREDIT	LN Year 2003 No. 51 TLN No. 4289	This PBI was issued along with developed interdependence between local and international payment system. This PBI regulates local payment system using local L/C. It includes bank obligations; document verification, local L/C transfer; and other related matters.
7.	No.5/7/PBI/2003 dated 19-05-2003	SHARIA BANK EARNING ASSETS	LN Year 2003 No.55 TLN No. 4291	Along with the unique characteristics of sharia banking sector, this PBI was issued to regulate sharia banks' earning assets. It includes assessment of earning assets and sanctions.
8.	No.5/8/PBI/2003 dated 10-05-2003	APPLICATION OF RISK-BASED MANAGEMENT FOR COMMERCIAL BANKS	LN Year 2003 No. 56 TLN No. 4292	This regulation was issued in line with increasing need of good governance and banks' risk management. It includes preparation to implement risk management, active supervision by Board

No.	PBI Number	Title	State Gazette	Description
				of Commissioners and Board of Directors; banks policies, risk identification and measurements, risk control and monitoring, risk management information, and reporting.
9.	No.5/9/PBI/2003 dated 19-05-2003	SHARIA BANK PROVISION FOR LOAN LOSSES	LN Year 2003 No. 57 TLN No. 4293	This PBI regulates sharia bank's obligation to set up provision for loan losses covering losses arising from the fund investment. It includes administration of provision for loan losses; collateral assessment; and sanctions.
10.	No.5/10/PBI/2003 dated 11-06-2003	PRUDENTIAL PRINCIPLE ON EQUITY PARTICIPATION	LN Year 2003 No. 66 TLN No. 4296	This PBI was issued along with the possibility of banks equity participation in other financial companies. It includes terms and conditon of equity participation; accounting treatment and equity participation quality; accounting treatment and temporary equity participation quality; transparency and sanctions.
11.	No.5/11/PBI/2003 dated 20-06-2003	PAYMENT OF IMPORT TRANSACTION	LN Year 2003 No. 71 TLN No. 4298	This PBI regulates payments of import transactions that have not been fully stipulated under the previous regulations. It includes import payments using L/C; without L/C; and sanctions.
12.	No.5/12/PBI/2003 dated 17-07-2003	THE ADJUSTED MARKET RISK CAPITAL ADEQUACY FOR COMMERCIAL BANKS	LN Year 2003 No. 83 TLN No. 4306	This PBI regulates the adjusted market risk capital adecuacy for commercial banks. It includes criterion to incude market risks into bank's capital adequacy; market risk aspects; minimum capital adequacy and sanctions.
13.	No.5/13/PBI/2003 dated 17-07-2003	COMMERCIAL BANK'S NET OPEN POSITION	LN Year 2003 No. 84 TLN No. 4307	This PBI is to complement PBI . 5/12/PBI/ 2003 concerning the Adjusted Market Risk Capital Adequacy.

No.	PBI Number	Title	State Gazette	Description
				It includes banks' obligation to maintain its net open position at the end of each working day, the calculation of outstanding option; exceptions for net open position, and submission of report.
14.	No.5/14/PBI/2003 dated 23-07-2003	OBLIGATION TO PROVIDE EDUCATION AND TRAINING FUNDS FOR BPRs HUMAN RESOURCES DEVELOPMENT	LN Year 2003 No. 90 TLN No. 4308	This PBI regulates BPRs' obligations to provide education and training funds for their human resources. The education and training funds shall be 5% (five percent) of previous year spending on this program and is to be effective starting 2004. The BPRs Board of Directors shall set up annual plan on education and training programs. This PBI also includes sanctions.
15.	No.5/15/PBI/2003 dated 14.08.2003	SHORT TERM FINANCING FACILITY FOR COMMERCIAL BANKS	LN Year 2003 No. 99 TLN No. 4317	ThIS PBI is improve previous PBI No. 2/20/ PBI/2000 of 12 September 2000 concerning short term financing facility (FPJP) for commercial banks. Under the previous PBI, the maximum limit of FPJP is based on bank's negative balance self assessment.. Under the current PBI, the maximum limit of FPJP include all bank's unsettled balance. Additionally, it also include Bank Indonesia's discretion to refuse the extention of FPJP more than 90 (ninety) days in succession.
16.	No.5/16/PBI/2003 dated 28-08-2003	THE THIRD AMENDMENT ON PBI No. 3/1/PBI/2001 CONCERNING MICRO CREDIT PROJECT	LN Year 2003 No.100 TLN No. 4318	This PBI regulates the amendment of PBI Number 3/1/PBI/2001 concerning the definition of "referred interest rate" (Article 1 point 11), and the determination of credit interest rate (Article 16).
17.	No.5/17/PBI/2003 dated 03-09-2003	TERMS AND CONDITIONS ON THE IMPLEMENTATION OF GOVERNMENT GUARANTY	LN Year 2003 No.101 TLN No.4319	This PBI is to complement Decree of the President of the Republic of Indonesia Number 193 Year 1998 dated 13 November 1998 regarding government's

No.	PBI Number	Title	State Gazette	Description
		ON BPRs' OBLIGATIONS		guarantee on BPRs obligations. Due to the absence of Deposit Insurance Institution, Bank Indonesia was assigned on behalf of the Government to guarantee BPR's financial obligations. This PBI includes terms and conditions to obtain the government guarantee, the disbursement and term-period of the guarantee program.
18.	No.5/18/PBI/2003 dated 09-09-2003	TECHNICAL ASSISTANCE FOR MICRO AND SMALL BUSINESS ENTERPRISES	LN Year 2003 No.102 TLN No. 4320	To promote development of Micro and Small Business Units, Bank Indonesia is allowed to provide a technical assistance to Service Provider Institution. The technical assistance is provided in the form of training and information.
19.	No.5/19/PBI/2003 dated 10-09-2003	SPECIAL TREATMENT ON BPRs CREDIT OR FINANCING POST BALI TRAGEDY	LN Year 2003 No.103 TLN No. 4321	To speed up economic recovery after the Bali Tradegy, a special treatment was extended to rescue the sharia-based BPRs loans or financing scheme at the Bali province. The special treatment includes credit rescheduling and restructuring. BPRs This special treatment is only limited to the following: a. credits and financing extended to productive activities in Bali province; b. credits or financing classified as "current " prior to the Bali tragedy. c. credit or financing which are now classified as non-performing due to the impact of Bali tragedy. This special treatment will be applied to the above credits expected to be upgraded to "current" category within one year period.
20.	No.5/20/PBI/2003 dated 17-09-2003	TRANSFER OF BANK INDONESIA LIQUIDITY CREDIT	LN Thn. 2003 No.105	Pursuant to Act No. 23 Year 1999, the management of Bank Indonesia Liquidity

No.	PBI Number	Title	State Gazette	Description
		(KLBI) MANAGEMENT UNDER THE SCHEME OF CREDIT PROGRAM	TLN No. 4322	Credit (KLBI) has been transfered to a State Owned Business Enterprise (BUMN) appointed by the Government. The transfer was previously regulated under PBI No. 2/3/PBI/2000 dated 1 February 2000. This PBI revokes the previous PBI of 2000. It explicitly describes the authority and task of the KLBI management body, including Bank Indonesia Claims on KLBI.
21.	No.5/21/PBI/2003 dated 17-10-2003	SECOND AMENDMENT OF BANK INDONESIA REGULATION NUMBER 3/10/ PBI/2001	LN Year 2003 No.111 TLN No. 4325	This PBI contains the amendment of several articles in PBI No. 3/10/PBI/2001 following the amendment of Act No. 25 Year 2003 (concerning the Amendment of Act No. 15 Year 2002 concerning Money Laundering).
22.	No.5/22/PBI/2003 dated 21-10-2003	THE ISSUANCE AND CIRCULATION OF 2003 RUPIAH COINS IN 500 (FIVE HUNDRED) AND 200 (TWO HUNDRED) DENOMINATION	LN Year 2003 No.113	This PBI regulates the issuance and circulation of 2003 coin in Rp500 and Rp200 denomination as a legal tender in the territory of the Republic of Indonesia.
23.	No.5/23/PBI/2003 dated 23-10-2003	THE APPLICATION OF KNOW YOUR CUSTOMER PRINCIPLE FOR BPRs	LN Year 2003 No.116 TLN No. 4328	Under this PBI, BPRs shall apply the KYC Principle in order to reduce their business risks. In applying this principle, BPRs shall establish prudential policies in dealing with their customers on a personal basis and in applying risk management according to the KYC principles.
24.	No.5/24/PBI/2003 dated 31-10-2003	THE INFORMATION CENTER OF MONEY MARKET	LN Year 2003 No.119 TLN No.4329	Article 2 of this PBI stipulates that banks shall become members of the Money Market Information Center *(Pusat Informasi Pasar Uang / PIPU)*. Incompliance to this article is subject to sanctions in the form of : a. written warning; b. summons for the bank managers;

No.	PBI Number	Title	State Gazette	Description
				c. payment obligation. Retribution service shall be charged to PIPU members and Subscribers.
25.	No.5/25/PBI/2003 dated 10-11-2003	FIT AND PROPER TEST	LN Year .2003 No.124 TLN No. 4334	This PBI revoked several regulations concering fit and proper test described in previous PBI. It contains wider scope of fit and proper tests conducted by Bank Indonesia as compare to those stated in the previous regulations. Under this PBI, the scope of fit and proper test is expanded not only to the incumbent bank's shareholders, managers, and executives but also to the candidates of shareholders, managers and executives. In addition, fit and proper test shall be applied to banks' ultimate shareholders. Under this regulation, those who are found to conduct disgraceful deed as stipulated by Bank Indonesia Decree No.27/118/KEP/DIR, of January 25, 1995 are prohibited to become banks' shareholders or banks executives for 20 years period and are automatically declared fail to pass the test.
26.	No.5/26/PBI/2003 dated 10-11-2003	MONTHLY REPORT OF SYARIAH COMMERCIAL BANK	LN Year 2003 No.136 TLN No. 4336	This PBI regulates the monthly reports of sharia commercial banks. It includes the frequency of report to be submitted, report corrections and sanctions.

Appendix E.2

Bank Indonesia Circular Letters (Extern) in 2003

No.	No. BI Circular Letter	Date	Issues
1.	5/1/DSM	30-01-2003	The Amendment Of Circular Letter No. 3/14/DSM Dated 13 June 2001 Concerning Reporting Of The Foreign Exchange Flows Activities By Non-Bank Financial Institutions
2.	5/2/DPM	03-02-2003	The Licensing Procedure And Supervision Of Non-Bank Money Changers
3.	5/3/DSM	10-02-2003	The Amendment Of Circular Letter No. 4/5/DSM Dated 28 March 2002 Concerning Reporting of Foreign Exchange Flows Activities By Non-Financial Institution Companies
4.	5/4/DPM	21-03-2003	Auction The Of Government Securities InThe Primary Market
5.	5/5/DPM	21-03-2003	The Criteria Requirements And Procedure On The Appointment Of Government Securities Auction Participants
6.	5/6/DPM	21-03-2003	The Procedure Of Government Securities Administration
7.	5/7/DPM	21-03-2003	The Requirements And Procedure Of Appointment Of Sub-Registry For The Administration Of Government Securities
8.	5/8/DPM	22-05-2003	The Amendment Of Bank Indonesia Circular Letter Number 5/6/DPM Dated 21 March 2003 Concerning The Procedure Of Government Securities Administration
9.	5/9/DPM	10-06-2003	The Procedure Of Issuance, Trading And Administration Of Bank Indonesia Certificate
10.	5/10/DPM	10-06-2003	The Implementation And Settlement Of Bank Indonesia Rupiah Deposit Facility (FASBI) In The Framework Of Open Market Operation

No.	No. BI Circular Letter	Date	Issues
11.	5/11/DPNP	26-06-2003	The Determination Of Deposit Interest Rate Margin Guaranteed By The Government
12.	5/12/DASP	07-07-2003	The Amendment Of Bank Indonesia Circular Letter Number 4/7/ DASP Dated 7 May 2002 Concerning Otomated Local Clearing Arrangement
13.	5/13/DASP	07-07-2003	The Amendment Of Bank Indonesia Circular Letter Number 4/15/ DASP Dated 30 September 2002 Concerning Electronic Local Clearing Arrangement
14.	5/14/DPNP	11-07-2003	The Procedure Of Licensing And Reporting For Commercial Bank Conducting Business Activities As Money Changer
15.	5/15/DASP	18-07-2003	Clearing Items, Clearing Documents And The Printing At Security Document Printing Companies
16.	5/16/DPM	06—8-2003	The Amendment Of Circular Letter No. 5/10/DPM Dated 10 June 2003 Concerning Implementation And Settlement Of Bank Indonesia Rupiah Deposit Facility In The Money Market
17.	5/17DASP	15-08-2003	The Third Amendment Of Bank Indonesia Circular Letter Number 2/ 24/DASP Dated 17 November 2000 Concerning Bank Indonesia Real Time Gross Settlement
18.	5/18/DSM	16-09-2003	The Second Amendment Of Bank Indonesia Circular Letter No. 2/ 19/DSM Dated 3 October 2000 Concerning Commercial Bank Monthly Report
19.	5/19/DPM	19-09-2003	The Amendment Of Bank Indonesia Circular Letter Number 5/6/ DPM Dated 21 March 2003 Concerning Procedure Of Government Securities Administration
20.	5/20/DPM	23-09-2003	The Procedure Of Short Term Funding Facility Provision For Bank Syariah
21.	5/21/DPNP	29-09-2003	The Application Of Management Risk By Commercial Banks
22.	5/22/DPNP	29-9-2003	Standard Guideline Of Internal Control For Commercial Banks

No.	No. BI Circular Letter	Date	Issues
23.	5/23/DPNP	29-09-2003	The Guideline Of Minimum Capital Requirement Calculation Taking Account Of Market Risks And The Guideline Of Commercial Bank Net Open Position Calculation
24.	5/24/DSM	03-10-2003	The Reporting Of Foreign Exchange Flow Activities By Non-Financial Institution Companies
25.	5/25/DPNP	23-10-2003	The Determination Of Third Party Deposit Interest Rate Margin Guaranteed By The Government
26.	5/26/BPS	27-10-2003	The Implementation Of Indonesian Syariah Banking Accounting Guideline
27.	5/27/DPBPR	31-10-2003	The Requirements And Procedure Of Government Guaranty Implementation For The Payment Obligation Of Rural Bank
28.	5/28/DPM	17-11-2003	The Procedure Of The Money Market Information Center Arrangement
29.	5/29/DPD	18-11-2003	The Brokerage Companies Of Rupiah And Foreign Exchange Money Market
30.	5/30/BKr	18-11-2003	The Transfer Of Bank Indonesia Liquidity Credit Management
31.	5/31/DSM	01-12-2003	The Monthly Report Of Syariah Commercial Banks
32.	5/32/DPNP	04-12-2003	The Amendment Of Bank Indonesia Circulation Letter Number 3/29/DPNP Concerning Standard Guideline Of Know Your Customer Principle Application
33.	5/33/DPM	04-12-2003	The Amendment Of Bank Indonesia Circular Letter Number 5/5/DPM Dated 21 March 2003 Concerning Criteria And Requirements And Procedure On The Appointment Of Government Securities Participant
34.	5/34/DPD	24-12-2003	The Procedure Of Foreign Exchange Transaction Data Submission Through The Money Market Information Center

Appendix E.3

Regulation and Important Policies in Economic and Finance in 2003

Date	Regulation/Policy	Number
January		
2	Tariff Exemption on Materials, Spare Parts, and Equipments Imports for Aircraft Reparation and Maintenance	Decree of the Minister of Finance No.6/KMK.01/2003
5	Compliance of Indonesia National Standardization on Raw Sugar	Decree of the Minister of Agriculture No.03/KPTs/KB.410/1/2003
8	Collection of Excise on Foreign Goods Entering Bonded Zone in Batam Island	Decree of the Minister of Finance No.17/KMK.04/2003
13	Decision on the Components of Balancing Funds for Fiscal Year 2003 to Provinces/Regencies/Municipalities.	Decree of the Minister of Finance No. 23/KMK.07/2003
15	Know Your Customer Principles	Decree of the Head of Capital Market Supervisory Agency No. KEP-02/PM/2003
20	The Establishment of National Logistic Agency	Government Regulation No.7, 2003
	Income Tax Received by Workers up to The Amount of Provincial Minimum Weight or Regency/City Minimum Wage	Government Regulation No. 5, 2003

Date	Regulation/Policy	Number
	The Third Amendment on Government Regulation No. 145, 2000 on Concerning Sales Tax on Luxury Goods	Government Regulation No. 6, 2003
22	Provisions on Export of Forestry Manufacturing Product	Decree of the Minister of Industry and Trade No. No.32/MPP/Kep/1/2003
	Planning, Implementation, and Monitoring of the Distribution of Foreign Loans to Regional Government	Decree of the Minister of Finance No.35/KMK.07/ 2003
28	Third Amendment on Decree of Minister of Finance No. 570/KMK.04/2000 Concerning Luxury Goods Excluding Motor Vehicles	Decree of the Minister of Finance No.39/KMK.03/ 2003
29	Small and Micro Enterprises Financing	Decree of the Minister of Finance No. 40/KMK.06/ 2003
30	Sales Tax on Luxury Goods, and/or other Taxable Luxury Goods Excluding Motor Vehicles	Decree of Director General of Taxation No. KEP-21/PPJ/2003
February		
17	The Injection of The Government Equity to PT Asuransi Ekspor Indonesia	Government Regulation No. 10 Tahun 2003
26	Utilization of General Allocation Fund and Balancing Fund for Fiscal Year 2003	Circular Letter of Directorate General of State Budget No. SE-37/ A/2003

Date	Regulation/Policy	Number
April		
9	Exemption and/or Restitution of Tariffs and/or Excise, Value Added Tax, Sales Tax on Imported Luxury Goods not to be Used as Inputs for Manufacturing or Export Oriented Industries	Decree of the Minister of Finance No.129/KMK.04/ 2003
May		
5	Stock Ownership and Securities Companies Capital	Decree of the Minister of Finance No.179/ KMK.010/2003
28	Procedures on Forwarding Customer Order on Foreign Future Contract	Decree of Head of Commodity Future Trading Regulatory Agency No. 41/ BAPPEBTI/KP/V/2003
29	The Injection of Government Equity to Bank Mandiri	Government Regulation No. 26, 2003
June		
17	Partnership Among SOEs, SMEs, and Environmental Awareness Programs	Decree of State Ministry of SOE's KEP-236/BMU/2003
19	State-Owned Enterprises	Act No 19, 2003
July		
8	The Amendment of Decree of The Minister of Trade and Industry No.458/MPP/Kep/7/2003 on Provisions and Procedures to Import Used City Buses	Decree of Minister of Industry and Trade No.710/MPP/Kep/12/ 2003

Date	Regulation/Policy	Number
17	Enlisting Procedures on Public Offering	Decree of Head of Capital Market Supervisory Agency No.KEP-25/PM/2003
	The Rights to Order Stocks in Advance	Decree of Head of Capital Market Supervisory Agency No.KEP-26/PM/2003
	Report on the Realization of Receipts From Public Offering	Decree of Head of Capital Market Supervisory Agency No.KEP-27/PM/2003
21	Additional Clause on the Decree of The Minister of Industry and Trade No.230/MPP/7/1997 regarding Import Restrictions	Decree of Minister of Industry and Trade No.417/MPP/Kep/6/2003
21	The Manual for Collective Investment Contract of Asset Backed Securities	Decree of Head of Capital Market Supervisory Agency No.KEP-28/PM/2003
25	The Auction on Repurchased Government Bond	Decree of the Minister of Finance No.343/KMK.01/2003
September		
15	Economic Policy Package Before and After the end of International Monetary Fund (IMF) Assistant Program	Presidential Instruction No.5, 2003

Date	Regulation/Policy	Number
October		
13	Amendment Act No. 5, 2002 on Money Laudering	Government Regulation No.25, 2003
	Divestment of Government Shares at PT Bank Rakyat Indonesia	Government Regulation No.49, 2003
18	Divestment of Government Shares at PT Indocement Tunggal Prakasa Tbk	Government Regulation No.50, 2003
27	The Injection for Government's Equity at PT PAL Indonesia's	Government Regulation No.52, 2003
	Amendment on Act No. 29, 2002 on State Budget Operation for Fiscal Year 2003	Act No. 26, 2003
November		
11	The National Team for Export and Investment Promotion	Presidential Decree No 87, 2003

Appendix F

Statistic Tabel

Table 1
Gross Domestic Product by Expenditure
(billions of rupiah)

Type of Expenditure	1998	1999	2000	2001	2002*	2003**
	Constant 1993 market prices					
Consumption	286,850.6	299,084.5	305,145.0	317,026.2	331,921.7	347,320.2
Private	260,022.7	272,070.2	276,377.2	285,674.7	296,559.3	308,477.4
Government	26,827.9	27,014.3	28,767.8	31,351.5	35,362.4	38,842.8
Gross domestic fixed capital formation	93,604.7	76,572.9	89,389.1	95,197.1	95,396.9	96,695.7
Change in stock	-6,386.9	-9,622.1	-13,794.2	-13,042.2	-17,568.5	-19,561.8
Exports of goods and services	134,707.2	91,863.6	116,193.6	119,600.2	118,920.0	123,724.0
less Import of goods and services	132,400.7	78,546.4	98,916.6	107,027.7	101,727.1	103,724.6
Gross Domestic Product	**376,374.9**	**379,352.5**	**398,016.9**	**411,753.6**	**426,943.0**	**444,453.5**
Net factor income from abroad	-27,965.4	-22,145.1	-25,391.1	-17,399.1	-22,217.8	-20,570.4
Gross National Product	**348,409.5**	**357,207.4**	**372,625.8**	**394,354.5**	**404,725.2**	**423,883.1**
less Net indirect tax	1,858.9	6,181.9	-11,746.1	8,865.6	18,925.5	21,238.3
less Depreciation	18,818.8	18,967.6	19,900.8	20,587.6	21,347.1	22,222.6
National Income	**327,731.8**	**332,057.9**	**364,471.1**	**364,901.3**	**364,452.6**	**380,422.2**
	Current market prices					
Consumption	702,239.5	885,814.6	941,598.4	1,086,354.4	1,252,382.7	1,402,593.0
Private	647,823.6	813,183.3	850,818.7	972,938.3	1,120,164.0	1,238,891.7
Government	54,415.9	72,631.3	90,779.7	113,416.1	132,218.7	163,701.3
Gross domestic fixed capital formation	243,043.4	221,472.3	275,881.3	314,065.8	326,165.2	352,360.5
Change in stock	-82,716.1	-96,461.4	-72,235.5	-53,623.9	-73,876.0	-67,257.5
Exports of goods and services	506,244.8	390,560.1	542,992.4	624,340.8	577,081.5	558,091.4
less Imports of goods and services	413,058.1	301,654.0	423,317.9	503,482.3	471,188.4	459,096.5
Gross Domestic Product	**955,753.5**	**1,099,731.6**	**1,264,918.7**	**1,467,654.8**	**1,610,565.0**	**1,786,690.9**
Net factor income from abroad	-53,893.7	-83,764.2	-92,161.8	-61,051.5	-54,513.0	-79,626.7
Gross National Product	**901,859.8**	**1,015,967.4**	**1,172,756.9**	**1,406,603.3**	**1,556,052.0**	**1,707,064.2**
less Net Indirect tax	6,480.5	17,950.1	-37,820.3	31,425.7	71,186.4	85,272.2
less Depreciation	47,787.7	54,986.6	63,245.9	73,382.8	80,528.3	89,334.5
National Income	**847,591.6**	**943,030.7**	**1,147,331.3**	**1,301,794.8**	**1,404,337.3**	**1,532,457.5**
Memorandum item:						
Per capita Gross Domestic Product[1)]						
in thousands of rupiah	4,814.7	5,489.7	6,145.1	7,025.6	7,596.9	8,304.3
in $	491.1	696.5	732.1	686.2	811.1	967.9
Per capita Gross National Product[1)]						
in thousands of rupiah	4,543.2	5,071.5	5,697.3	6,733.3	7,339.8	7,934.2
in $	463.4	643.5	678.8	657.7	783.6	924.7
Per capita National Income[1)]						
in thousands of rupiah	4,269.8	4,707.5	5,573.8	6,231.6	6,624.1	7,122.7
in $	435.5	597.3	664.0	608.7	707.2	830.1

1) At market prices
Source : BPS-Statistics Indonesia

Table 2
Gross Domestic Product by Sector
(billions of rupiah)

Sector	Constant 1993 market prices						Current market prices					
	1998	1999	2000	2001	2002*	2003**	1998	1999	2000	2001	2002*	2003**
Agriculture, livestock, forestry, and fishery	**63,609.5**	**64,985.3**	**66,208.9**	**67,318.5**	**68,669.7**	**70,374.4**	**172,827.6**	**215,686.7**	**217,897.9**	**244,721.9**	**275,271.4**	**296,237.5**
Food crops	33,350.4	34,012.4	34,533.8	34,260.2	34,533.8	35,070.1	91,346.0	116,222.5	112,661.2	126,065.2	141,411.2	146,349.7
Non-food crops	10,501.8	10,702.0	10,722.0	11,331.9	11,807.6	12,417.2	33,289.6	35,966.5	33,744.7	37,371.8	42,010.4	47,049.5
Livestock and products	6,439.7	6,836.9	7,061.3	7,312.7	7,485.2	7,745.2	15,743.6	23,761.2	27,034.6	30,466.8	35,121.7	39,043.1
Forestry	6,580.7	6,288.1	6,388.9	6,556.2	6,682.2	6,658.9	11,700.5	13,803.8	14,947.8	15,597.4	16,952.9	19,001.5
Fishery	6,736.9	7,145.8	7,502.9	7,857.5	8,160.9	8,483.0	20,747.9	25,932.8	29,509.7	35,220.7	39,775.1	44,793.8
Mining and quarrying	**37,474.0**	**36,865.8**	**38,896.4**	**39,401.3**	**40,404.8**	**40,590.8**	**120,328.6**	**109,925.4**	**175,262.5**	**193,540.9**	**178,197.1**	**191,176.9**
Crude petroleum and natural gas	23,340.1	22,136.8	22,658.3	21,537.3	21,079.4	20,358.2	74,883.7	72,424.9	129,220.9	132,381.4	116,750.7	123,643.1
Mining (excl. oil and gas)	9,678.0	10,357.7	11,619.2	13,026.9	14,188.2	14,584.4	35,459.9	27,696.1	34,495.7	47,016.5	44,615.8	47,615.1
Quarrying	4,455.9	4,371.2	4,618.9	4,837.0	5,137.2	5,648.2	9,984.9	9,804.3	11,545.9	14,143.0	16,830.6	19,918.7
Manufacturing	**95,320.6**	**99,058.5**	**104,986.9**	**108,272.3**	**111,982.5**	**115,900.7**	**238,897.0**	**285,873.9**	**314,918.4**	**372,915.9**	**409,666.3**	**440,451.8**
Oil and gas	11,042.2	11,797.2	11,599.9	11,196.5	11,332.7	11,398.6	33,172.4	35,127.6	54,279.9	56,087.1	59,999.1	68,103.7
Petrollum and refinery	6,310.0	6,606.6	6,843.1	6,958.0	6,773.7	6,767.8	15,092.2	16,320.8	22,602.9	27,701.9	33,787.6	39,291.1
LNG	4,732.3	5,190.6	4,756.9	4,238.5	4,559.0	4,630.8	18,080.2	18,806.8	31,676.9	28,385.3	26,211.5	28,812.6
Non-oil and gas	84,278.4	87,261.3	93,387.0	97,075.8	100,649.8	104,502.1	205,724.7	250,746.3	260,638.5	316,828.7	349,667.2	372,348.1
Electricity, gas, and water supply	**5,646.1**	**6,112.9**	**6,574.8**	**7,111.9**	**7,538.4**	**8,052.2**	**11,283.1**	**13,429.0**	**16,519.3**	**22,169.5**	**30,492.1**	**39,665.4**
Construction	**22,465.3**	**22,035.6**	**23,278.7**	**24,308.2**	**25,488.4**	**27,196.2**	**61,761.6**	**67,616.2**	**76,573.4**	**85,601.8**	**93,966.1**	**107,118.8**
Trade, hotels, and restaurants	**60,130.7**	**60,093.7**	**63,498.3**	**65,824.6**	**68,333.3**	**70,891.3**	**146,740.1**	**175,835.4**	**199,110.4**	**235,738.4**	**265,535.1**	**291,589.8**
Wholesale and retail trade	47,845.9	47,574.5	50,333.8	51,997.8	53,871.4	55,766.9	116,688.5	140,588.7	159,384.7	189,492.8	212,511.4	232,391.9
Hotels and restaurants	12,284.8	12,519.2	13,164.5	13,826.8	14,461.9	15,124.5	30,051.6	35,246.7	39,725.7	46,245.6	53,023.7	59,197.8
Transportation and Communication	**26,975.1**	**26,772.1**	**29,072.1**	**31,338.9**	**33,855.1**	**37,475.5**	**51,937.2**	**55,189.6**	**62,305.6**	**74,247.3**	**92,796.6**	**111,727.7**
Transportation	20,503.8	19,737.6	21,176.3	22,451.7	23,569.7	25,507.4	41,837.2	42,735.7	47,911.3	57,913.8	67,687.8	81,036.3
Comminication	6,471.3	7,034.5	7,895.8	8,887.2	10,285.4	11,968.1	10,100.0	12,453.9	14,394.3	16,333.5	25,108.9	30,691.4
Financial, rental, and business services	**28,278.7**	**26,244.6**	**27,449.4**	**28,932.3**	**30,590.8**	**32,512.5**	**69,891.7**	**71,220.2**	**80,459.9**	**94,819.2**	**110,157.9**	**123,000.7**
Banks [1]	13,173.0	11,861.8	12,467.5	13,252.1	14,022.0	14,821.8	31,710.2	31,088.6	36,317.3	43,347.8	50,331.4	54,929.8
Rental and business services	15,105.7	14,382.8	14,981.8	15,680.2	16,568.9	17,690.7	38,181.5	40,131.6	44,142.6	51,471.4	59,826.6	68,070.9
Services	**36,475.0**	**37,184.0**	**38,051.5**	**39,245.4**	**40,080.1**	**41,459.9**	**82,086.8**	**104,955.3**	**121,871.4**	**143,900.0**	**154,482.2**	**185,722.3**
Public administration	21,887.5	22,250.6	22,555.1	22,795.4	22,887.0	23,103.0	40,641.0	56,745.0	69,460.2	81,850.9	83,293.5	101,605.6
Private	14,587.5	14,933.4	15,496.4	16,450.1	17,193.1	18,356.9	41,445.8	48,210.3	52,411.3	62,049.1	71,188.7	84,116.6
Gross Domestic Product	**376,374.9**	**379,352.5**	**398,016.9**	**411,753.5**	**426,942.9**	**444,453.5**	**955,753.5**	**1,099,731.6**	**1,264,918.7**	**1,467,654.8**	**1,610,565.0**	**1,786,690.9**
Non-oil and gas	**341,992.5**	**345,418.5**	**363,758.7**	**379,019.6**	**394,530.8**	**412,696.7**	**847,697.4**	**992,179.1**	**1,081,417.9**	**1,279,186.3**	**1,433,815.1**	**1,594,944.1**
Oil and gas	**34,382.4**	**33,934.0**	**34,258.2**	**32,733.8**	**32,412.2**	**31,756.7**	**108,056.1**	**107,552.5**	**183,500.8**	**188,468.5**	**176,749.8**	**191,746.8**

1) Including non-bank financial institutions and financial supporting services.
Source : BPS-Statistics Indonesia

Table 3
Terms of Trade Effect on Gross Domestic Product
(billions of rupiah)

Items	1998	1999	2000	2001	2002*	2003**
1. Exports of goods and services at current market prices	506,244.8	390,560.1	542,992.4	624,340.8	577,081.5	558,091.4
2. Exports of goods and services at constant market prices	134,707.2	91,863.6	116,193.6	119,600.2	118,920.0	123,724.0
3. Export deflator (1:2) x 100)	375.8	425.2	467.3	522.0	485.3	451.1
4. Imports of goods and services at current market prices	413,058.1	301,654.0	423,317.9	503,482.3	471,188.4	459,096.5
5. Imports of goods and services at constant market prices	132,400.7	78,546.4	98,916.6	107,027.7	101,727.1	103,724.6
6. Import deflator (4:5) x 100)	312.0	384.0	428.0	470.4	463.2	442.6
7. Terms of trade index (3:6) x 100)	120.5	110.7	109.2	111.0	104.8	101.9
8. Changes in terms of trade index (%)	5.43	-8.10	-1.36	1.62	-5.59	-2.72
9. Real Import capacity of export (1:6) x 100)	162,270.6	101,696.3	126,880.9	132,719.2	124,588.9	126,090.7
10. Terms of trade effect (9 - 2)	27,563.4	9,832.7	10,687.3	13,119.0	5,668.9	2,366.7
11. Changes in terms of trade effect (%)	59.60	-64.33	8.69	22.75	-56.79	-58.25
12. GDP at constant 1993 market prices	376,374.9	379,352.5	398,016.9	411,753.6	426,943.0	444,453.5
13. Changes in GDP at constant 1993 market prices (%)	-13.13	0.79	4.92	3.45	3.69	4.10
14. Gross Domesti Income (10 - 12)	-348,811.5	-369,519.8	-387,329.6	-398,634.6	-421,274.1	-442,086.8
15. Changes in Gross Domestic Income (%)	-16.15	5.94	4.82	2.92	5.68	4.94

Source : BPS-Statistics Indonesia (processed)

Table 4
Selected Agricultural Products
(thousands of tons)

Items	1998	1999	2000	2001	2002	2003
Food crops						
Paddy	49,237	50,866	51,899	50,461	51,490	51,849 [1)]
Corn	10,169	9,204	9,677	9,347	9,654	10,821 [1)]
Cassava	14,696	16,459	16,089	17,055	16,913	17,723 [1)]
Sweet potatoes	1.935	1,665	1,828	1,749	1,772	1,719 [1)]
Peanuts	692	660	737	710	718	760 [1)]
Soybeans	1,306	1,383	1,018	827	673	678 [1)]
Mung beans	306.1	265.1	289.9	286.5	288.1	311.4 [1)]
Estate crops						
Dry Rubber	332.6	293.7	336.2	309.0	193.4	57.4 [2)]
Palm Oil	4,013.1	4,454.5	4,094.0	3,863.6	2,246.8	710.2 [2)]
Palm Kernel	912.1	1,012.4	930.6	878.2	510.7	161.4 [2)]
Chocolate	60.9	58.9	60.5	60.5	31.9	8.1 [2)]
Coffee	28.5	27.5	29.5	29.4	17.9	0.6 [2)]
T e a	132.7	126.4	127.8	117.1	78.0	21.5 [2)]
Kina	0.4	0.9	0.6	0.6	0.4	0.2 [2)]
Sugarcane	1,928.7	1,801.4	1,896.3	1,896.2	1,035.0	3.4 [2)]
Tobacco	7.7	5.8	14.8	14.8	2.2	0.1 [2)]
Forestry						
Logs	29,520.3	19,026.9	20,619.9	13,798.2		
Sawn Timber	2,613.5	2,707.2	2,060.2	3,020.9		
Plywood	6,709.8	7,154.7	4,611.9	3,711.1		
Livestock						
Meat	1,228.5	1,193.5	1,445.2	1,560.5	1,583.0	
Eggs	529.8	640.4	783.3	850.4	908.9	
Milk (millions of litres)	375.4	436.0	495.7	480.0	520.9	
Fisherry						
Sea	3,837.0	3,950.0	...	...		
Inland	1,000.0	1,020.0	...	...		

1) Data up to April 2003
2) Data up to February 2003
Sources : - Ministry of Agriculture
- Ministry of Forestry and Plantation
- BPS-Statistics Indonesia

Table 5
Production, Harvested Area, and Average Production of Food Crops

Items	1996	1997	1998	1999	2000	2001	2002	2003 1)
Production (thousands of tons)								
Paddy	61,101.5	49,377.1	49,236.7	50,866.4	51,898.9	50,460.8	51,489.7	51,849.2
Corn	9,307.4	8,770.9	10,169.4	9,204.04	9676.9	9,347.19	9,654.1	10,820.6
Cassava	17,002.5	15,134.0	14,696.2	16,458.5	16,089.0	17.054.6	16,913.1	17,722.8
Sweet potatoes	2,017.5	1,847.5	1,935.0	1,665.6	1,827.7	1,749.1	1,771.6	1,719.1
Peanuts	737.8	688.3	692.4	659.6	736.5	709.8	718.1	759.5
Soybeans	1,517.2	1,356.9	1,305.6	1,382.8	1,017.6	826.9	673.1	677.5
Mung beans	301.4	261.7	306.1	265.1	289.9	286.5	288.1	311.4
Harvested area (thousands of hectares)								
Paddy	11,569.7	11,140.6	11,730.3	11,963.2	11,793.5	11,500.0	11,521.2	11,452.7
Corn	3.,743.6	3,355.2	3,847.8	3,456.4	3,500.3	3,285.9	3,126.8	3,380.2
Cassava	1,415.1	1,243.4	1,205.4	1,350.0	1,284.0	1,317.9	1,276.5	1,200.5
Sweet potatoes	211.7	195.4	202.1	172.2	194.3	181.0	177.3	170.8
Peanuts	688.9	628.1	651.1	625.0	683.6	654.8	647.0	670.2
Soybeans	1,279.3	1,119.1	1,095.1	1,151.1	824.5	678.8	544.5	530.2
Mung beans	331.0	294.2	339.2	298.1	131.3	339.3	313.6	330.4
Production (quintal per hectares)								
Paddy	52.8	44.3	42.0	42.5	44.0	43.9	44.7	45.3
Corn	24.9	26.1	26.4	26.6	27.6	28.5	30.9	32.0
Cassava	120.2	121.7	121.9	121.9	125.3	129.0	132.0	148.0
Sweet potatoes	95.3	94.5	95.8	96.7	94.1	97.0	100.0	101.0
Peanuts	10.7	11.0	10.6	10.6	10.8	10.8	11.1	11.3
Soybeans	11.9	12.1	11.9	12.0	12.3	12.2	12.4	12.8
Mung beans	9.1	8.9	9.0	8.9	22.1	8.9	9.2	9.4

1) Projection figures
Source : - BPS-Statistics Indonesia

Table 6
Selected Mining and Quarrying Products

Product	Unit	1996	1997	1998	1999	2000	2001	2002	2003
Oil and gas Mining									
Crude oil [1]	Millions of barrels	553.9	544.8	537.5	495.5	517.5	489.9	458.5	379.3 [2]
LNG	Thousand of Metric tons	26,261.8	27,136.7	27,179.9	29,812.4	27,203.0	24,343.7	26,184.7	10,797.6 [3]
LPG	Thousand of Metric tons	3,273.7	2,805.1	2,312.2	2,249.8	2,047.3	2,190.1	1,765.4	1,779.7 [3]
Non oil and gas Mining									
C o a l	Thousand of Metric tons	47,338.6	52,074.3	60,320.8	69,357.6	76,820.2	90,253.8	103,060.4	54,798.1 [4]
Nickel	Thousand of Metric tons	3,426.9	2,829.9	2,734.0	3,245.3	3,349.3	3,635.4	4,366.2	2,189.3 [4]
Copper [1]	Thousand of Metric tons	1,758.9	1,840.7	2,640.0	2,645.2	3,193.5	3,289.5	3,786.7	1,324.7 [4]
T i n	Thousand of Metric tons	51.0	55.2	54.0	47.8	50.2	61.9	88.1	13.3 [4]
Bauxite	Thousand of Metric tons	842.0	808.7	1,055.6	1,142.5	1,175.4	1,275.6	1,283.5	641.1 [4]
Iron sand	Thousand of Metric tons	425.1	487.4	561.0	562.3	538.9	490.1	378.6	165.5 [4]
Gold	Thousands of kilograms	83.7	90.0	124.0	129.0	117.6	166.1	142.2	55.4 [4]
Silver	Thousands of kilograms	254.9	270.4	350.0	292.3	334.6	348.3	288.8	110.2 [4]

1) Including Condenser
2) Data up to November 2003
3) Data up to May 2003
4) Data up to June 2003

Sources :
- Ministry of Mining and Energy
- Directorate General of Mining and Energy
- BPS-Statistics Indonesia

Table 7
PLN Electric Power Distributions
(millions of KWH)[1]

Y e a r	1996	1997	1998	1999	2000	2001	2003	2003[1]
Total	**56,932**	**64,315**	**64,383**	**71,338**	**79,050**	**84,029**	**86,504**	**82,232**
Social	1,277	1,396	1,426	1,489	1,667	1,809	1,849	1,843
Household	19,478	22,642	24,391	26,859	30,506	27,382	33,799	32,396
Business	7,452	8,660	8,507	9,332	10,224	10,914	11,208	11,500
Industry	26,722	29,358	27,779	31,339	33,994	35,519	36,753	33,508
Public	2,002	2,257	2,280	1,342	2,097	2,396	2,547	2,662
Multipurpose	-	-	-	977	562	252	205	324

1) Data up to November 2003
Source : State Electricity Corporation (PLN)

Table 8
Regional Daily Minimum Wage by Province
(rupiah)

Province	1998	1999	2000	2001	2002	2003
Aceh Darussalam	147,000	171,000	265,000	300,000	330,000	425,000
North Sumatra	174,000	210,000	254,000	340,500	464,000	505,000
West Sumatra	137,000	160,000	200,000	250,000	385,000	435,000
Riau				329,000	394,000	437,500
a. Outside Batam	174,000	218,000	329,000	n.a.	n.a.	n.a.
b. Batam	270,000	290,000	350,000	n.a.	n.a.	n.a.
Jambi	137,500	150,000	173,000	245,500	304,000	390,000
South Sumatra				255,000	331,500	403,500
a. Mainlands	146,500	170,000	196,000	n.a.	n.a.	n.a.
b. Islands	155,500	181,000	209,000	n.a.	n.a.	n.a.
Bengkulu	145,000	150,000	173,000	240,000	295,000	330,000
Lampung	146,500	160,000	192,000	240,000	310,000	350,000
Banten					360,000	475,000
DKI Jakarta	198,500	231,000	245,000	426,250	591,266	631,554
West Java				245,000	280,779	320,000
a. Area I	198,500	230,000	270,000	n.a.	n.a.	n.a.
b. Area II	181,000	210,000	245,000	n.a.	n.a.	n.a.
c. Area III	167,500	200,000	230,000	n.a.	n.a.	n.a.
d. Area IV	160,000	195,000	225,000	n.a.	n.a.	n.a.
Central Java	130,000	153,000	185,000	245,000	314,500	340,400
D.I. Yogyakarta	122,500	130,000	194,500	237,500	312,750	360,000
East Java				220,000	245,000	281,750
a. Area I	152,500	182,000	236,000	n.a.	n.a.	n.a.
b. Area II	146,500	174,000	212,000	n.a.	n.a.	n.a.
c. Area III	139,000	166,000	208,000	n.a.	n.a.	n.a.
d. Area IV	134,000	160,000	202,000	n.a.	n.a.	n.a.
Bali	162,500			309,750	341,000	341,000
a. Badung, Denpasar	n.a.	187,000	214,300	n.a.	n.a.	n.a.
b. Others	n.a.	166,000	190,000	n.a.	n.a.	n.a.
West Nusa Tenggara	124,000	145,000	180,000	240,000	320,000	375,000
East Nusa Tenggara	122,500	143,000	184,000	275,000	330,000	350,000
East Timor	158,500	183,000	n.a.	n.a.	n.a.	
West Kalimantan	145,500	175,000	228,000	304,500	380,000	400,000
Central Kalimantan	158,500	195,000	285,000	362,000	362,000	425,000
South Kalimantan	144,000	166,000	200,000	295,000	377,500	425,000
East Kalimantan	176,000	194,000	233,000	300,000	500,000	540,000
North Sulawesi	135,500	155,000	186,000	372,000	438,000	495,000
Central Sulawesi	122,500	150,000	203,000	245,000	350,000	410,000
South Sulawesi	129,500	148,000	200,000	300,000	375,000	415,000
Southeast Sulawesi	139,000	160,000	210,000	275,000	325,000	390,000
Maluku	156,500	180,000	180,000	320,000	285,000	370,000
North Maluku				320,000	322,000	322,000
Gorontalo					375,000	410,000
Irian Jaya	195,500	225,000	315,000	400,000	530,000	600,000

Source : Ministry of Manpower and Transmigration (processed)

Table 9
Approved Domestic Investment Projects by Sector
(billions of rupiah)

Sector	1999	2000	2001	2002	2003
Agriculture, Forestry, and Fishery	**2,408.3**	**1,578.7**	**1,378.1**	**1,453.7**	**1,929.1**
Agriculture	1,614.8	1,408.3	777.6	1,452.2	1,657.9
Forestry	749.3	35.0	445.9	0.0	94.3
Fishery	44.2	135.4	154.6	1.5	176.9
Mining	**174.0**	**36.4**	**1,198.2**	**786.7**	**752.8**
Manufacturing	**46,747.5**	**81,976.1**	**41,609.1**	**15,853.5**	**40,442.7**
Food	12,729.9	8,547.6	8,957.0	4,967.6	4,246.6
Textile	2,561.5	2,386.4	2,217.4	440.0	2,111.7
Wood	1,229.0	168.8	546.5	409.1	562.9
Paper	20,244.1	8,174.2	4,771.0	150.1	245.0
Chemical and pharmaceutical	2,480.9	56,435.9	22,236.2	1,953.1	30,204.6
Non-metal mineral	70.4	3,523.0	596.5	217.1	932.5
Basic metal	6,354.2	274.3	287.0	7,179.2	0.0
Metal products	1,070.7	2,465.9	0.0	0.0	1,002.6
Others	6.8	0.0	1,997.5	537.3	1,136.8
Construction	**395.1**	**843.6**	**2,006.9**	**1,499.8**	**1,773.7**
Hotel	**1,379.9**	**153.5**	**2,459.1**	**683.2**	**929.7**
Tranportation	**225.3**	**1,801.6**	**1,489.0**	**3,117.7**	**2,022.0**
Real estate and office buildings	**995.5**	**292.6**	**4,540.9**	**255.1**	**1.4**
Other services	**1,226.3**	**1,611.9**	**1,635.1**	**1,612.6**	**633.4**
Total	**53,551.9**	**88,294.4**	**56,316.4**	**25,262.3**	**48,484.8**

Source : Investment Coordination Board (BKPM)

Table 10
Approved Distribution of Domestic Investment Projects by Province
(billions of rupiah)

Province	1999	2000	2001	2002	2003
Java and Madura	**22,126.8**	**17,314.0**	**20,283.8**	**12,780.9**	**11,283.4**
Jakarta	1,260.5	3,521.8	7,845.7	4,013.7	2,667.6
West Java	18,393.9	9,742.2	7,024.8	5,587.3	5,567.3
Central Java	849.6	1,019.5	2,184.8	1,462.9	1,947.2
Yogyakarta	34.6	119.9	105.9	43.4	23.0
East Java	1,588.2	2,910.6	3,122.6	1,673.6	1,078.3
Sumatra	**14,746.3**	**35,584.3**	**9,023.1**	**5,946.2**	**3,500.9**
Aceh	94.2	89.6	64.4	1.2	98.9
North Sumatra	1,079.4	363.8	1,192.9	2,275.6	868.5
West Sumatra	597.6	575.5	7.5	0.0	289.8
Riau	9,091.5	33,285.1	5,705.5	1,474.2	770.7
Jambi	3,001.7	882.2	771.5	447.4	107.4
South Sumatra	149.3	67.7	625.6	12.0	839.9
Bengkulu	121.4	22.5	0.0	55.2	81.9
Lampung	611.2	297.9	655.7	1,680.6	443.8
Kalimantan	**5,359.5**	**4,277.7**	**3,776.8**	**2,722.9**	**2,100.2**
West Kalimantan	222.6	21.1	10.0	23.7	485.5
Central Kalimantan	3,561.4	331.5	164.3	491.8	516.0
South Kalimantan	410.5	3,064.8	188.4	149.4	346.4
East Kalimantan	1,165.0	860.3	3,414.1	2,058.0	752.3
Sulawesi	**1,795.8**	**30,297.4**	**20,265.0**	**3,546.0**	**29,766.9**
North Sulawesi	51.8	1,487.5	1,174.7	127.8	142.3
Central Sulawesi	543.9	262.6	1,068.3	94.8	217.7
South Sulawesi	696.2	28,380.4	16,653.7	141.4	29,239.8
Southeast Sulawesi	503.9	166.9	1,368.3	3,182.0	167.1
Nusa Tenggara	**35.2**	**757.0**	**1,647.5**	**15.4**	**128.1**
West Nusa Tenggara	14.9	755.5	566.5	0.4	5.8
East Nusa Tenggara	20.3	1.5	1,081.0	15.0	122.3
Bali	**1,002.7**	**21.6**	**540.2**	**28.8**	**706.5**
Maluku	**20.0**	**0.0**	**0.0**	**68.0**	**2.9**
Irian Jaya	**8,416.0**	**42.5**	**3,137.5**	**154.1**	**995.9**
T o t a l	**53,550.1**	**88,294.5**	**58,673.9**	**25,262.3**	**48,484.8**

Source : - Investment Coordination Board (BKPM)

Table 11
Approved Foreign Direct Investment Projects by Sector
(millions of $)

Sector	1999	2000	2001	2002	2003
Agriculture, forestry, and fishery	**491.2**	**443.5**	**391.7**	**458.9**	**178.9**
Agriculture	412.7	388.9	284.2	446.3	57.2
Forestry	8.8	5.0	100.6	8.9	95.2
Fishery	69.7	49.6	6.9	3.7	26.5
Mining	**14.1**	**1.1**	**118.7**	**49.2**	**17.8**
Manufacturing	**6,929.3**	**10,633.7**	**5,144.4**	**3,208.2**	**6,457.4**
Food	681.0	701.3	289.2	267.3	408.5
Textile	240.2	400.3	330.0	89.9	123.1
Wood	113.2	157.0	21.4	30.4	235.0
Paper	1,411.8	88.0	742.3	10.0	1,300.0
Chemical and pharmaceutical	3,268.2	7,406.4	2,309.9	1,872.7	3,034.6
Non-metal mineral	110.4	9.6	107.9	32.6	711.4
Basic metal	501.3	830.7	652.1	348.9	0.0
Metal products	593.0	1,005.5	0.0	0.0	323.4
Others	10.2	34.9	691.6	556.4	321.4
Construction	**153.4**	**125.3**	**47.6**	**287.7**	**787.7**
Hotel	**228.6**	**257.0**	**6,891.6**	**254.6**	**488.2**
Transportation	**102.7**	**1,217.3**	**373.3**	**3,713.2**	**4,160.2**
Real estate and office buildings	**179.4**	**301.5**	**177.5**	**7.4**	**10.3**
Other services	**2,791.9**	**2,303.4**	**1,899.1**	**1,764.9**	**1,106.7**
Total	**10,890.6**	**15,282.8**	**15,043.9**	**9,744.1**	**13,207.2**

Source : - Investment Coordination Board (BKPM)

Table 12
Approved Distribution of Foreign Direct Investment Projects by Province
(millions of $)

Province	1999	2000	2001	2002	2003
Java and Madura	**2,635.9**	**10,539.9**	**5,738.5**	**4,780.9**	**7,430.6**
Jakarta	783.8	3,270.5	1,152.3	3,373.4	5,611.6
West Java	1,498.2	3,138.0	2,780.0	1,053.6	1,294.2
Central Java	69.7	3,013.8	117.1	71.6	89.7
Yogyakarta	10.5	4.0	10.1	19.8	17.4
East Java	273.7	1,113.6	1,679.0	262.5	417.7
Sumatra	**7,652.6**	**2,945.6**	**2,352.2**	**2,078.2**	**1,541.2**
Aceh	51.8	1,811.1	6.0	0.0	82.5
North Sumatra	102.7	193.3	106.5	44.5	57.6
West Sumatra	344.9	18.5	38.2	10.0	45.3
Riau	6,956.9	418.0	2,095.4	1,152.4	1,175.3
Jambi	42.0	252.7	5.7	21.6	0.6
South Sumatra	39.7	215.5	44.6	764.0	178.8
Bengkulu	18.4	0.2	1.9	0.0	0.0
Lampung	96.2	36.3	53.9	85.7	1.1
Kalimantan	**226.8**	**137.0**	**242.6**	**2,236.6**	**780.7**
West Kalimantan	102.0	3.3	21.8	1.3	33.0
Central Kalimantan	50.3	74.8	11.8	8.9	32.2
North Kalimantan	30.3	3.1	9.8	34.0	2.1
East Kalimantan	44.2	55.8	199.2	2,192.4	713.4
Sulawesi	**141.8**	**68.5**	**81.1**	**380.2**	**225.1**
North Sulawesi	24.1	22.2	1.2	1.3	181.3
Central Sulawesi	2.7	1.8	0.5	0.3	0.0
South Sulawesi	12.5	36.5	78.9	373.6	43.8
Southeast Sulawesi	102.5	8.0	0.5	5.0	0.0
Nusa Tenggara	**15.0**	**1,413.5**	**5.9**	**121.9**	**2,806.0**
West Nusa Tenggara	13.6	1,408.5	4.7	119.4	2,805.6
East Nusa Tenggara	1.4	5.0	1.2	2.5	0.4
Bali	**193.8**	**125.8**	**519.0**	**86.6**	**198.5**
Maluku	**1.7**	**0.1**	**9.3**	**0.0**	**3.0**
Irian Jaya	**23.2**	**52.4**	**6.095.6**	**59.7**	**222.0**
Total	**10,890.8**	**15,282.8**	**15.044.2**	**9.744.1**	**13,207.1**

Source : - Investment Coordination Board (BKPM)

Table 13
Approved Foreign Direct Investment Projects by Country of Origin
(millions of $)

Country of Origin	1999	2000	2001	2002	2003
Europe	**730.2**	**5,864.8**	**922.7**	**1,358.3**	**1,264.1**
Netherlands	48.7	1,159.2	88.6	244.1	99.4
Belgium	9.8	5.7	0.2	7.1	5.9
United Kingdom	507.0	3,574.0	722.9	720.0	966.1
Germany	87.1	958.6	42.6	35.7	170.8
France	22.7	64.4	14.3	262.6	5.7
Switzerland	42.1	42.2	11.7	74.3	0.3
Others	12.8	60.7	42.4	14.5	15.9
America	**144.2**	**254.3**	**81.4**	**480.9**	**380.0**
United States	136.7	243.1	72.7	467.7	173.5
Canada	3.2	3.6	8.4	7.2	2.3
Others	4.3	7.6	0.3	6.0	204.2
Asia	**6,486.1**	**3,824.0**	**12,205.3**	**6,138.1**	**2,661.5**
Hongkong	76.9	106.2	39.7	1,712.0	169.5
Japan	644.3	1,961.1	772.0	510.4	1,252.2
South Korea	263.0	688.4	369.6	369.7	122.1
Malaysia	186.1	167.7	2,240.3	71.6	155.3
Philippines	4.9	7.4	2.0	63.2	39.7
Singapore	731.1	535.0	1,140.5	3,328.0	518.9
Taiwan	1,489.3	131.0	72.3	37.7	136.7
Thailand	8.4	6.8	3.0	4.7	9.8
Others	3,082.1	220.4	7,565.9	40.8	257.3
Australia	**2,458.5**	**58.6**	**255.5**	**233.0**	**125.6**
Africa	**65.6**	**466.5**	**560.0**	**875.5**	**4,462.2**
Joint countries	**1,006.0**	**4,814.6**	**1,018.6**	**658.3**	**1,313.8**
T o t a l	**10,890.6**	**15,282.8**	**15,043.5**	**9,744.1**	**10,207.2**

Source : - Investment Coordination Board (BKPM)

Table 14
Consumer Price Index

End of Period 1)	Food-stuffs	Prepared food, beverages, cigarettes and tobacco	Housing	Clothing	Medical care	Education, recreation and sport	Transpor-tation and Communi-cation	General Index	Change in General Index (%)
1994 2)	156.97	-	178.57	147.53	161.69	-	-	163.17	9.24
1995	179.14	-	188.93	157.42	173.33	-	-	177.83	8.64
1996	189.99	-	198.00	166.76	190.72	-	-	189.62	6.47
1997	227.88	-	210.36	179.96	206.72	-	-	211.62	11.05
1998	263.22	211.58	159.03	219.71	212.54	161.84	163.70	198.64	77.54
1999									**2.01**
January - March	282.04	216.34	162.21	233.73	215.41	162.08	169.22	206.75	4.20
April - June 3)	268.58	215.17	164.61	227.49	217.79	163.09	170.32	204.07	-1.30
July - September	239.06	216.26	166.12	229.63	220.00	169.52	169.94	198.68	-2.64
October - December	249.54	219.20	166.77	233.21	220.37	170.44	172.20	202.45	1.90
2000									**9.35**
January	256.85	220.00	167.56	237.47	220.87	170.43	173.68	205.12	1.32
February	256.00	220.17	168.34	239.79	221.85	170.23	173.45	205.27	0.07
March	250.16	219.97	169.05	240.09	222.43	171.83	174.01	204.34	-0.45
April	246.16	225.28	171.03	240.50	224.87	173.50	176.83	205.48	0.56
May	246.08	225.07	174.18	242.55	225.76	174.91	181.19	207.21	0.84
June	246.47	227.25	174.87	244.54	226.50	175.41	182.54	208.24	0.50
July	251.39	229.45	176.06	248.54	229.42	178.51	183.37	210.91	1.28
August	246.68	231.43	176.71	247.01	230.43	195.70	184.69	211.99	0.51
September	240.76	232.73	177.93	247.12	236.19	198.02	186.65	211.87	-0.06
October	241.37	237.42	180.60	248.68	238.16	199.24	191.19	214.33	1.16
November	246.96	241.62	182.93	249.95	240.47	199.50	191.78	217.15	1.32
December	259.53	243.49	183.61	256.98	241.46	200.28	194.00	221.37	1.94
2001									**12.55**
January	258.68	245.87	184.74	259.03	242.26	200.61	193.21	222.10	0.33
February	263.04	247.59	185.96	258.88	244.77	201.38	194.29	224.04	0.87
March	265.51	250.49	188.19	260.70	247.97	202.17	195.00	226.04	0.89
April	262.89	252.77	190.09	264.85	252.17	203.41	196.06	227.07	0.46
May	266.84	255.28	191.63	270.08	254.79	203.89	197.42	229.63	1.13
June	270.43	261.35	194.72	271.94	257.03	204.61	204.14	233.46	1.67
July	274.88	266.46	197.93	272.10	259.74	209.40	218.09	238.52	2.17
August	268.42	267.54	199.69	264.80	260.26	218.08	218.12	237.92	-0.25
September	266.45	269.14	203.04	266.57	260.62	222.74	219.75	239.44	0.64
October	269.53	270.38	203.89	271.77	261.32	223.38	219.99	241.06	0.68
November	282.50	272.38	206.05	274.81	262.26	223.57	220.14	245.18	1.71
December	290.74	278.75	208.57	277.90	262.99	224.12	221.47	249.15	1.62
2002									**10.03**
January	298.72	286.47	213.58	278.74	264.94	224.60	223.18	254.12	1.99
February	308.00	288.76	217.15	279.69	266.50	225.50	225.78	257.93	1.50
March	299.31	289.27	219.02	279.34	268.06	226.25	235.88	257.87	-0.02
April	293.58	289.94	219.96	279.08	269.41	226.30	237.96	257.26	-0.24
May	295.29	290.15	221.68	278.95	271.22	226.93	246.06	259.31	0.80
June	294.47	290.17	223.80	278.28	272.37	226.57	251.21	260.25	0.36
July	293.99	291.93	225.83	279.15	273.77	236.77	253.42	262.38	0.82
August	292.43	292.36	227.64	279.64	275.18	242.78	253.19	263.13	0.29
September	293.48	293.30	230.07	280.15	275.96	247.43	252.19	264.53	0.53
October	294.96	296.33	231.00	281.18	276.62	247.99	253.77	265.95	0.54
November	309.80	301.30	232.64	283.72	277.03	248.15	254.21	270.87	1.85
December	317.29	304.35	235.08	285.38	277.79	248.43	255.85	274.13	1.20
2003									**5.06**
January	312.41	310.30	240.51	288.11	280.70	248.48	258.74	276.33	0.80
February	310.48	312.68	242.04	289.94	281.82	248.47	258.95	276.87	0.20
March	303.47	313.93	244.64	289.80	284.18	248.14	259.09	276.23	-0.23
April	299.97	318.35	245.03	287.94	285.09	248.80	262.48	276.65	0.15
May	299.12	318.39	246.90	288.95	287.40	248.81	262.56	277.23	0.21
June	296.66	318.95	249.14	289.78	287.94	249.18	262.90	277.49	0.09
July	294.53	318.25	250.08	290.43	288.68	252.94	263.04	277.58	0.03
August	294.97	317.89	251.60	291.25	289.35	272.71	263.27	279.92	0.84
September	293.43	318.96	254.20	293.10	291.17	277.14	263.40	280.93	0.36
October	298.64	319.06	254.96	293.84	292.03	277.50	263.48	282.48	0.55
November	305.34	320.07	256.02	300.57	292.51	277.42	266.27	285.32	1.01
December	311.84	323.35	256.74	305.60	293.54	277.52	266.34	287.99	0.94

1) Figures at the end of period (year/quarter)
2) From April 1998 to March 1998 = 100 with 4 categories, column (1) refers to food; colum (6) refers to miscellanous
3) From January 1996 to December 1996 = 100, CPI was calculated based on survey in 44 cities and comodities were classified into 7 categories
4) Since October 1999, CPI is calculated based on survey in 43 cities (excl. Dili)
Sources : - BPS-Statistics Indonesia

Table 15
Wholesale Price Index[1)]

Group	1998	1999	2000	2001	2002	2003[2]	Change 2003 to 2002 (%)
Agriculture	298	410	459	567	614	564	-8.19
Mining and quarry	173	214	236	275	307	328	6.81
Manufacturing	217	268	278	309	339	354	4.29
Imports	286	289	316	356	345	346	0.29
Exports	417	366	461	521	497	505	1.52
Oil and gas	348	355	634	669	615	664	7.97
Non-oil and gas	444	370	393	462	450	441	-1.90
General Index	288	314	353	403	414	422	1.95

1) Annual figure is the average of monthly index over the year
2) Average up to November 2003
Source : BPS-Statistics Indonesia

Table 16
Inflation Rates in 43 Cities
(percent)

City	1998[1]	1999	2000[2]	2001	2002	2003
Lhokseumawe	79.66	6.61	8.73	11.67	10.99	4.53
Banda Aceh	79.01	5.57	10.57	16.60	10.14	3.50
Padang Sidempuan	85.72	-0.14	3.95	9.84	10.18	4.07
Sibolga	85.01	1.65	6.95	8.66	11.58	3.94
Pematang Siantar	80.23	-0.54	4.67	13.55	9.41	2.51
Medan	83.81	1.68	5.90	15.50	9.49	4.46
Padang	87.20	4.23	10.99	9.86	10.22	5.55
Pekanbaru	75.86	4.35	10.34	14.65	11.66	6.65
Batam	52.89	-0.28	9.00	12.64	9.14	4.27
Jambi	72.31	0.49	8.40	10.11	12.62	3.79
Palembang	89.18	-1.01	8.49	15.15	12.25	5.03
Bengkulu	84.10	0.47	8.21	10.58	10.11	4.14
Bandar Lampung	85.22	3.34	10.18	12.94	10.32	5.44
Jakarta	74.42	1.77	10.29	11.52	9.08	5.78
Tasikmalaya	73.55	1.58	4.57	16.71	10.29	3.88
Serang/Cilegon	65.43	-0.04	7.03	12.75	9.68	5.21
Bandung	72.59	4.29	8.52	11.91	11.97	5.69
Cirebon	62.23	4.75	6.52	12.93	10.53	3.35
Purwokerto	80.93	0.99	10.02	11.76	8.77	2.89
Surakarta	66.38	0.46	7.89	15.58	8.64	1.73
Semarang	67.19	1.51	8.73	13.98	13.56	6.07
Tegal	67.73	1.11	7.85	11.26	11.27	1.86
Yogyakarta	77.46	2.51	7.32	12.56	12.01	5.73
Jember	84.95	3.16	10.35	13.92	9.75	5.20
Kediri	77.08	-0.64	7.05	15.91	8.87	1.13
Malang	93.16	1.49	10.62	12.45	9.74	3.23
Surabaya	95.21	0.24	10.46	14.13	9.15	4.79
Denpasar	75.11	4.39	9.81	11.52	12.49	4.56
Mataram	90.50	0.59	5.19	14.76	7.96	1.82
Kupang	62.58	10.65	10.62	12.34	9.77	5.45
Pontianak	78.85	4.49	8.34	10.60	8.61	5.48
Sampit	75.94	-4.98	11.87	14.69	7.59	3.06
Palangkaraya	74.65	-0.13	8.57	13.35	9.18	5.68
Banjarmasin	74.43	1.47	7.57	8.36	9.18	6.77
Balikpapan	75.10	3.01	10.67	10.82	11.38	5.92
Samarinda	68.31	3.69	11.91	10.21	10.26	7.99
Manado	74.24	7.41	11.41	13.30	15.22	0.69
Palu	95.18	3.58	8.41	18.73	13.36	5.84
Makassar	80.86	1.64	9.73	11.77	8.25	3.01
Kendari	97.79	1.29	11.25	12.56	10.35	2.41
Ternate	72.98	0.38	14.51	13.71	6.40	6.27
Ambon	75.82	8.26	8.52	14.12	9.47	2.51
Jayapura	61.83	3.49	10.23	14.00	13.91	8.39
National Inflation	**77.63**	**2.01**	**9.35**	**12.55**	**10.03**	**5.06**

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 $)

Items	1999	2000	2001	2002	2003*
I. Current Account	**5,783**	**7,992**	**6,900**	**7,823**	**7,709**
1. Trade balance	**20,644**	**25,042**	**22,695**	**23,512**	**24,438**
a. Export f.o.b	51,243	65,407	57,364	59,165	63,450
b. Import f.o.b	-30,599	-40,366	-34,669	-35,653	-39,011
2. Services (Net)	**-14,861**	**-17,050**	**-15,795**	**-15,690**	**-16,729**
II. Capital Account[1]	**-5,944**	**-8,166**	**-7,617**	**-1,102**	**-1,656**
A Public Sector	**3,830**	**1,347**	**-99**	**-190**	**-598**
B Private Sector	**-9,774**	**-9,513**	**-7,518**	**-912**	**-1,059**
1 Direct Investment	-1,866	-4,550	-2,977	145	-955
2 Portfolio Investment	-1,792	-1,911	-244	1,222	2251
3 Others	-6,116	-3,052	-4,296	-2,279	-2,355
C. Total (A+B)	**-161**	**-175**	**-717**	**6,721**	**6,053**
D. Errors and Omissions (net)	**2,080**	**4,094**	**714**	**-1,694**	**-2,446**
E. Monetary Movement	**-1,919**	**-3,919**	**3**	**-5,027**	**-3,606**
Changes in Reserve Assets[2]	**-3,292**	**-5,042**	**1,378**	**-4,021**	**-4,209**
IMF	**1,373**	**1,123**	**-1,375**	**-1,006**	**603**
Notes:					
1. Reserve Assets	27,054	29,394	28,016	32,037	36,246
In Months of Imports and Official Debt Repayment	6.1	6.0	5.9	6.6	7.1
2. Current Account/GDP (%)	4.1	3.4	4.7	4.5	3.8

1) Including rescheduling
2) Minus (-) : Surplus and vice versa. Since 2000 based on changes in reserve assets replacing GFA

Table 18
Export Value of Non-Oil and Gas by Commodity
(millions of $)

Items	1999	2000	2001	2002	2003 1)
Total Exports	**40,987**	**50,341**	**44,805**	**46,307**	**47,928**
Agriculture	**4,179**	**4,152**	**3,557**	**3,905**	**4,191**
Wood	86	97	105	54	48
Rubber	854	883	810	988	1,309
Coffee	465	327	161	211	219
Tea	102	115	97	108	96
Pepper	183	227	105	77	74
Tobacco	108	80	95	73	72
Tapioca	23	11	12	6	3
Animal and animal products	1,574	1,622	1,499	1,431	1,444
- Shrimps	886	971	864	750	787
Skins	74	94	80	69	74
Others	710	695	592	888	854
Mining	**4,130**	**5,566**	**5,620**	**5,535**	**6,431**
Tin	242	234	245	274	307
Copper	1,441	2,272	2,416	2,343	2,789
Nickel	219	360	299	52	222
Aluminum	138	260	212	227	207
Coal	1,665	1,635	1,945	2,233	2,480
Others	425	805	503	406	425
Manufacturing	**32,678**	**40,623**	**35,628**	**36,867**	**37,306**
Textiles & textile products	6,291	7,317	6,752	6,266	6,342
- Garments	3,450	4,067	3,821	3,344	3,459
Handicrafts	569	548	532	510	480
Wood and wood products	4,526	4,495	3,962	3,896	3,792
- Plywoods	2,259	1,996	1,725	1,564	1,410
Rattan products	255	296	272	284	298
Palm Oil	1,369	1,265	1,343	2,291	2,613
Copra oil-cake	47	62	49	68	65
Chemical product	1,835	2,259	2,146	2,360	2,696
Metal products	1,078	1,217	1,131	1,073	1,156
Electrical appliances	3,365	6,366	6,115	6,641	6,290
Cement	143	141	170	112	90
Paper	2,645	3,046	2,677	2,460	2,558
Rubber products	374	440	429	523	578
Glass and glassware	279	349	306	314	323
Footwear	1,519	1,620	1,433	1,346	1,264
Plastic products	860	1,216	1,024	1,059	1,045
Machinery and mechanical	1,853	3,783	3,054	3,207	3,015
Others	5,670	6,205	4,234	4,457	4,702

1) Projection figure

Table 19
Export Volume of Non-Oil and Gas by Commodity
(thousands of tons)

Items	1999		2000		2001		2001		2003 [1]	
	Volume	Share (%)	Volume	Share (%)	Volume	Share (%)	Volume	Share (%)	Volume	Share (%)
Total Exports	175,610	100.0	176,353	100.0	226,385	100.0	174,627	100.0	160,496	100.0
Agriculture	**5,395**	**3.1**	**4,467**	**2.5**	**4,579**	**2.0**	**4,314**	**2.5**	**4,126**	**2.6**
Wood	679	0.4	685	0.4	849	0.4	490	0.3	496	0.3
Rubber	1,544	0.9	1,410	0.8	1,554	0.7	1,511	0.9	1,196	0.7
Coffe	362	0.2	363	0.2	270	0.1	290	0.2	294	0.2
Tea	107	0.1	109	0.1	96	0.0	102	0.1	99	0.1
Pepper	35	0.0	67	0.0	54	0.0	45	0.0	36	0.0
Tobacco	78	0.0	32	0.0	46	0.0	44	0.0	43	0.0
Tapioca	300	0.2	161	0.1	173	0.1	58	0.0	74	0.0
Animal and animal products	819	0.5	664	0.4	567	0.3	613	0.4	679	0.4
- Shrimps	164	0.1	182	0.1	147	0.1	152	0.1	141	0.1
Skins	38	0.0	11	0.0	10	0.0	9	0.0	11	0.0
Others	1,433	0.8	965	0.5	960	0.4	1,152	0.7	1,264	0.8
Mining	**116,809**	**66.5**	**125,015**	**70.9**	**174,330**	**77.0**	**123,673**	**70.8**	**99,673**	**62.1**
Tin	47	0.0	46	0.0	70	0.0	80	0.0	61	0.0
Copper	2,261	1.3	3,144	1.8	3,110	1.4	3,303	1.9	2,469	1.5
Nickel	2,008	1.1	1,918	1.1	2,414	1.1	3,036	1.7	516	0.3
Aluminum	1,125	0.6	1,204	0.7	1,318	0.6	1,605	0.9	1,749	1.1
Coal	53,899	30.7	59,742	33.9	68,496	30.3	77,782	44.5	85,951	53.6
Others	57,469	32.7	58,961	33.4	98,922	43.7	37,867	21.7	13,802	8.6
Manufacturing	**49,307**	**28.1**	**46,871**	**26.6**	**47,476**	**21.0**	**46,640**	**26.7**	**43,204**	**26.9**
Textiles and textile products	1,525	0.9	1,677	1.0	1,685	0.7	1,733	1.0	1,709	1.1
- Garments	333	0.2	351	0.2	347	0.2	315	0.2	307	0.2
Handicraft	196	0.1	205	0.1	246	0.1	230	0.1	206	0.1
Wood and wood products	6,791	3.9	6,770	3.8	6,242	2.8	6,299	3.6	6,135	3.8
- Plywood	4,302	2.4	3,970	2.3	3,668	1.6	3,265	1.9	3,275	2.0
Rattan products	114	0.1	130	0.1	110	0.0	126	0.1	126	0.1
Palm Oil	3,600	2.0	4,521	2.6	5,728	2.5	7,433	4.3	6,032	3.8
Copra oil-cake	983	0.6	1,225	0.7	1,309	0.6	1,142	0.7	1,133	0.7
Chemical products	5,378	3.1	5,916	3.4	5,604	2.5	6,047	3.5	6,028	3.8
Metal products	3,191	1.8	1,515	0.9	1,667	0.7	1,889	1.1	1,702	1.1
Electrical appliances	437	0.2	692	0.4	689	0.3	801	0.5	788	0.5
Cement	7,383	4.2	7,292	4.1	10,190	4.5	7,545	4.3	4,888	3.0
Paper	9,048	5.2	5,048	2.9	4,626	2.0	5,051	2.9	5,688	3.5
Rubber products	209	0.1	279	0.2	264	0.1	285	0.2	319	0.2
Glass and glassware	1,555	0.9	960	0.5	807	0.4	1,452	0.8	883	0.6
Footwear	165	0.1	157	0.1	148	0.1	127	0.1	137	0.1
Plastics products	1,045	0.6	1,195	0.7	1,006	0.4	1,303	0.7	1,034	0.6
Machinery and mechanical	166	0.1	288	0.2	278	0.1	332	0.2	364	0.2
Others	7,156	4.1	4,680	2.7	6,877	3.0	4,845	2.8	5,227	3.3

1) Projection figure

Table 20
Export Value of Non-Oil and Gas by Country of Destination
(millions of $)

Continent/Country	1999		2000		2001		2001		2003 1)	
	Value	Share (%)	Value	Share (%)	Value	Share (%)	Value	Share (%)	Value	Share (%)
Africa	1,032	2.5	1,157	2.3	1,120	2.5	1,126	2.4	1,232	2.6
America	7,679	18.7	9,993	19.9	8,753	19.5	8,699	18.8	8,345	17.4
United States	6,297	15.4	8,463	16.8	7,385	16.5	7,354	15.9	7,116	14.8
Latin America	429	1.0	626	1.2	557	1.2	577	1.2	515	1.1
Canada	346	0.8	446	0.9	405	0.9	381	0.8	392	0.8
Others	607	1.5	458	0.9	406	0.9	387	0.8	323	0.7
Asia	23,574	57.5	28,579	56.8	25,219	56.3	26,462	57.1	28,121	58.7
Asean	8,799	21.5	10,204	20.3	8,989	20.1	9,456	20.4	9,876	20.6
Brunei	27	0.1	24	0.0	29	0.1	32	0.1	32	0.1
Malaysia	1,440	3.5	1,861	3.7	1,706	3.8	1,929	4.2	2,244	4.7
Philippines	670	1.6	861	1.7	807	1.8	789	1.7	952	2.0
Singapore	5,185	12.7	6,073	12.1	5,058	11.3	5,120	11.1	4,927	10.3
Thailand	958	2.3	928	1.8	955	2.1	998	2.2	1,082	2.3
Myanmar	105	0.3	64	0.1	66	0.1	51	0.1	46	0.1
Vietnam	324	-	337	0.7	299	0.7	477	1.0	542	1.1
Kamboja	69	-	55	0.1	68	0.2	61	0.1	51	0.1
Laos	2	-	1	0.0	1	0.0	0	0.0	0	0.0
Hongkong	1,452	3.5	1,574	3.1	1,267	2.8	1,258	2.7	1,268	2.6
India	837	2.0	1,088	2.2	981	2.2	1,245	2.7	1,678	3.5
Iraq	65	0.2	95	0.2	89	0.2	28	0.1	20	0.0
Japan	6,007	14.7	7,844	15.6	6,934	15.5	6,545	14.1	6,910	14.4
South Korea	1,335	3.3	1,710	3.4	1,634	3.6	1,904	4.1	1,779	3.7
Pakistan	156	0.4	148	0.3	182	0.4	246	0.5	300	0.6
People's Republic of China	1,541	3.8	1,828	3.6	1,573	3.5	2,144	4.6	2,633	5.5
Arab Saudi	444	1.1	535	1.1	477	1.1	463	1.0	405	0.8
Taiwan	1,280	3.1	1,487	3.0	1,228	2.7	1,209	2.6	1,194	2.5
Others	1,677	4.1	2,065	4.1	1,864	4.2	1,964	4.2	2,058	4.3
Australia/Oceania	1,058	2.6	1,080	2.1	1,029	2.3	1,359	2.9	1,317	2.7
Europe	7,645	18.7	9,532	18.9	8,683	19.4	8,662	18.7	8,913	18.6
European Community	6,996	17.1	8,774	17.4	7,719	17.2	7,532	16.3	7,685	16.0
Netherlands	1,519	3.7	1,895	3.8	1,639	3.7	1,548	3.3	1,363	2.8
Belgium dan Luxembourg	713	1.7	892	1.8	730	1.6	786	1.7	884	1.8
United Kingdom	1,219	3.0	1,575	3.1	1,594	3.6	1,412	3.0	1,128	2.4
Italy	628	1.5	708	1.4	605	1.4	622	1.3	752	1.6
Germany	1,262	3.1	1,435	2.9	1,277	2.9	1,257	2.7	1,437	3.0
France	525	1.3	730	1.5	598	1.3	618	1.3	692	1.4
Others	1,131	2.8	1,540	3.1	1,275	2.8	1,289	2.8	1,429	3.0
Former Soviet Union	51	0.1	81	0.2	60	0.1	71	0.2	100	0.2
Other Eastern Europe	240	0.6	243	0.5	237	0.5	309	0.7	353	0.7
Others	357	0.9	433	0.9	667	1.5	750	1.6	775	1.6
TOTAL	40,987	100.0	50,341	100.0	44,805	100.0	46,307	100.0	47,928	100.0

1) Projection figure

Table 21
Import Value of Non-Oil and Gas by Country of Origin (FOB)
(millions of $)

Continent/Country	1999		2000		2001		2002		2003 1)	
	Value	Share(%)	Value	Share(%)	Value	Share(%)	Value	Share(%)	Value	Share(%)
Africa	**489**	**1.7**	**496**	**1.3**	**540**	**1.7**	**404**	**1.3**	**426**	**1.3**
America	**5,414**	**18.7**	**6.086**	**16.4**	**4,943**	**15.8**	**4,480**	**14.4**	**4,748**	**14.3**
United States	3,996	13.8	4.362	11.8	3,926	12.5	3,318	10.7	3,532	10.6
Latin America	797	2.7	722	1.9	469	1.5	612	2.0	610	1.8
Canada	567	2.0	868	2.3	486	1.6	511	1.6	560	1.7
Others	54	0.2	133	0.4	61	0.2	39	0.1	46	0.1
Asia	**15,036**	**51.9**	**20.996**	**56.6**	**17,657**	**56.4**	**18,391**	**59.2**	**19,600**	**59.0**
Asean	**4,937**	**17.0**	**5.251**	**14.2**	**4,785**	**15.3**	**5,121**	**16.5**	**5,432**	**16.3**
Brunei	2	0.0	2	0.0	2	0.0	2	0.0	3	0.0
Malaysia	666	2.3	906	2.4	882	2.8	998	3.2	1,037	3.1
Philippines	76	0.3	159	0.4	122	0.4	153	0.5	156	0.5
Singapore	2,254	7.8	2.613	7.0	2,414	7.7	2,274	7.3	2,430	7.3
Thailand	1,295	4.5	1.397	3.8	1,255	4.0	1,439	4.6	1,510	4.5
Myanmar	27	0.1	29	0.1	26	0.1	45	0.1	50	0.2
Vietnam	615	2.1	142	0.4	82	0.3	132	0.4	245	0.7
Kamboja	2	0.0	1	0.0	1	0.0	1	0.0	2	0.0
Laos	0	0.0	2	0.0	0	0.0	-	0.0	-	0.0
Hongkong	334	1.2	488	1.3	326	1.0	304	1.0	321	1.0
India	364	1.3	627	1.7	638	2.0	792	2.5	869	2.6
Iraq	0.0	0.0	0	0.0	3	0.0	3	0.0	-	0.0
Japan	3,997	13.8	7,094	19.1	5,298	16.9	5,660	18.2	6,016	18.1
South Korea	1,673	5.8	2,474	6.7	2,264	7.2	1,815	5.8	1,958	5.9
Pakistan	155	0.5	73	0.2	89	0.3	61	0.2	67	0.2
People's Republic of China	1,634	5.6	2,414	6.5	2,086	6.7	2,714	8.7	2,845	8.6
Arab Saudi	189	0.7	301	0.8	264	0.8	220	0.7	231	0.7
Taiwan	1,094	3.8	1,718	4.6	1,430	4.6	1,289	4.1	1,403	4.2
Others	660	2.3	555	1.5	473	1.5	411	1.3	458	1.4
Australia/Oceania	**2,201**	**7.6**	**2,558**	**6.9**	**2,386**	**7.6**	2,145	**6.9**	**2,313**	**7.0**
Eropa	**5,857**	**20.2**	**6,950**	**18.7**	**5,803**	**18.5**	**5,648**	**18.2**	**6,157**	**18.5**
European Community	**4,761**	**16.4**	**5,255**	**14.2**	**4,543**	**14.5**	**4,258**	**13.7**	**4,683**	**14.1**
Netherlands	494	1.7	611	1.6	440	1.4	452	1.5	488	1.5
Belgium dan Luxembourg	225	0.8	395	1.1	270	0.9	252	0.8	271	0.8
United Kingdom	786	2.7	934	2.5	757	2.4	530	1.7	575	1.7
Italy	366	1.3	455	1.2	522	1.7	548	1.8	620	1.9
Germany	1,938	6.7	1,727	4.7	1,644	5.2	1,616	5.2	1,803	5.4
France	516	1.8	648	1.7	517	1.7	538	1.7	572	1.7
Others	436	1.5	485	1.3	392	1.3	321	1.0	354	1.1
Former Soviet Union	161	0.6	319	0.9	210	0.7	234	0.8	247	0.7
Other Eastern Europe	70	0.2	65	0.2	57	0.2	97	0.3	100	0.3
Others	865	3.0	1,312	3.5	993	3.2	1,059	3.4	1,126	3.4
TOTAL	**28,997**	**100.0**	**37,087**	**100.0**	**31,328**	**100.0**	**31,068**	**100.0**	**33,244**	**100.0**

1) Projection figure

Table 22
Exports of Oil and Gas [1)]

Items	1999	2000	2001	2002	2003
Export Value[2)]					
Oil and oil products	5,680	7,954	6,921	6,548	7,469
Gas					
- LNG	4,207	6,756	5,270	5,595	6,858
- LPG	369	356	369	323	321
- Natural Gas	-	-	-	392	874
Total	**10,256**	**15,066**	**12,560**	**12,466**	**14,648**
Export Volume					
Oil and oil products (millions of barrels)	336	291	297	271	262
Gas					
- LNG (MMBTU) [3)]	1,511	1,400	1,222	1,360.29	1,433.46
- LPG (Thousand of MTon)	1,865	1,215	1,251	1,312	1,096
- Natural Gas (Millions of MMBTU)	-	-	-	99.4	224.2

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) Consists of crude oil and oil products.
3) MMBTU : Million British Thermal Unit

Table 23
Money Supply
(billions of rupiah)

End of Period	M1[1)]		Quasi Money[2)]		M2[3)]		
	Outstanding	Share (%)	Outstanding	Share (%)	Outstanding	Change (%)	
						Annual	Quaterly
1999 [4)]	124,633	19.3	521,572	80.7	646,205	11.9	-0.9
1999/2000	124,663	19.0	531,788	81.0	656,451	8.8	1.6
2000	162,186	21.7	584,842	78.3	747,028	15.6	8.8
2001	177,731	21.1	666,323	78.9	844,054	13.0	7.8
2002							
March	166,173	20.0	665,237	80.0	831,410	8.4	-1.5
June	174,017	20.8	664,618	79.2	838,635	5.3	0.9
September	181,791	21.1	677,915	78.9	859,706	9.8	2.5
December	191,939	21.7	691,969	78.3	883,908	4.7	2.8
2003							
January	180,111	20.6	693,572	79.4	873,683	4.3	
February	181,530	20.6	699,685	79.4	881,215	5.3	
March	181,239	20.6	696,537	79.4	877,776	5.6	-0.7
April	182,963	20.7	699,846	79.3	882,809	6.6	
May	191,707	21.5	701,322	78.5	893,029	7.2	
June	195,219	21.8	699,335	78.2	894,554	6.7	1.9
July	196,589	21.8	705,124	78.2	901,713	5.7	
August	201,859	22.3	703,640	77.7	905,499	5.7	
September	207,587	22.8	703,636	77.2	911,223	6.0	1.9
October	212,614	23.0	713,710	77.0	926,324	7.3	
November	224,318	23.7	720,329	76.3	944,647	8.6	
December	223,799	23.4	731,893	76.6	955,692	8.1	4.9

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)

Items	1999	2000	2001	2002	2003	2003			
						I	II	III	IV
Money Supply									
M2	68,824	100,823	97,026	39,854	71,784	-6,132	16,437	17,011	44,469
M1	23,436	37,553	15,545	14,208	31,860	-10,700	13,639	12,697	16,212
Currency	16,959	14,018	3,971	4,344	13,856	-8,363	4,768	4,027	13,424
Demand deposits	6,477	23,535	11,574	9,864	18,004	-2,337	8,871	8,682	2,788
Quasi money 1)	45,388	63,270	81,481	25,646	39,924	4,568	2,798	4,302	28,257
Affecting factors :									
Net foreign assets	-12,581	81,637	23,242	16,721	21,124	-960	-13,076	4,121	31,039
Net claims on central government	425,287	123,060	9,389	-19,355	-31,337	-44	-4,089	-24,666	-2,539
Net claims on IBRA	-29,693	-	-	-	-	-	-	-	-
Claims on business sector	-299,689	42,347	34,233	60,143	77,472	11,057	17,522	22,907	25,986
Claims on official entities/ state enterprises	-8,139	-4,505	3,980 r	4,552r	-1,489	-525	2,072	-188	-2,848
Claims on private enterprises and individuals	-291,550	46,852	30,250 r	55,591r	78,961	11,582	15,450	23,095	28,834
Net other items	-14,500	-146,221	30,162	-17,655	4,468	-16,185	23,916	14,649	-10,017

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 1999		December 2000		December 2001		December 2002		December 2003	
	Rupiah	Foreign Currency	Rupiah	Foreign Currency	Rupiah	Foreign Currency	Rupiah	Foreign Currency	Rupiah	Foreign Currency
State banks										
1 -month	12.52	5.44	12.05	6.37	16.59	4.95	12.84	2.63	6.61	1.60
3 -months	13.19	5.45	13.33	6.59	17.47	5.36	13.65	2.73	7.11	1.68
6 -months	14.44	7.94	13.42	6.17	16.55	5.67	13.86	2.71	7.96	1.90
12 -months	23.14	8.91	12.48	6.24	15.81	5.95	15.67	3.32	10.55	2.13
24 -months	18.53	14.87	14.32	10.23	18.06	6.34	18.05	5.57	16.13	2.36
Private national banks										
1 -month	12.14	5.34	12.05	6.07	15.83	4.05	12.90	2.33	6.63	1.17
3 -months	12.66	5.68	13.20	6.43	16.94	4.90	13.77	2.69	7.20	1.40
6 -months	13.55	7.98	13.16	6.23	15.58	5.32	13.91	2.73	8.65	1.57
12 -months	17.07	16.63	11.50	11.39	14.74	5.70	14.73	3.25	10.07	2.32
24 -months	17.59	8.02	14.22	8.14	17.22	6.27	17.18	6.23	15.55	3.01
Regional government banks										
1 -month	12.2	5.09	11.39	4.97	15.04	5.05	12.81	2.48	6.78	1.20
3 -months	12.51	6.19	12.92	4.56	15.98	4.71	13.56	2.65	7.31	1.31
6 -months	13.46	5.18	12.94	5.13	15.61	5.48	14.14	4.17	8.63	1.41
12 -months	16.17	5.67	11.43	5.05	14.99	5.37	14.44	3.50	10.84	2.75
24 -months	13.73	...	13.44	...	17.42	...	17.72	...	17.01	...
Foreign banks and joint banks										
1 -month	9.46	4.08	9.73	4.61	12.96	1.92	10.50	1.86	6.54	1.70
3 -months	9.24	4.03	11.21	4.81	12.35	2.00	9.89	1.92	6.66	1.67
6 -months	9.05	4.31	8.13	4.12	11.63	2.58	9.66	2.39	6.38	2.00
12 -months	13.46	4.67	8.51	5.09	12.99	3.40	11.68	2.40	8.61	2.45
24 -months	11.67	4	13.00	6.05	8.72	2.53	15.97	3.21	15.80	3.10
Commercial banks										
1 -month	12.24	5.15	11.96	5.94	16.07	4.18	12.81	2.44	6.62	1.26
3 -months	12.95	5.24	13.24	6.11	17.24	4.35	13.63	2.65	7.14	1.54
6 -months	14.25	7.85	13.31	5.72	16.18	5.12	13.79	2.70	8.25	1.84
12 -months	22.35	9.11	12.17	7.86	15.48	5.62	15.28	3.24	10.39	2.23
24 -months	18.38	14.63	14.32	9.47	18.05	6.32	18.02	5.28	16.13	2.71

1) Weighted average at the end of period

Table 26
Inter-bank Money Market in Jakarta[1]

End of Period		Value of transaction (billions of rupiah)	Weighted average interest rate (percent per annum)
1999	January - December	4,411	7.61
2000	January - December	2,272	10.58
2001	January - December	3,194	14.56
2002	January - December	3,749	14.20
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			
	Januari - 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			
	January - March	3,739	16.18
	April - June	3,878	15.19
	July - September	3,806	13.56
	October - December	3,574	11.86
2003 [1)]			
	January	3,226	10.99
	February	3,305	10.51
	March	3,548	10.38
	Januari - March	3,360	10.63
	April	4,200	10.41
	May	3,230	9.89
	June	3,610	9.01
	April - June	3,680	9.77
	Juli	3,337	8.19
	August	3,591	8.33
	September	3,001	7.47
	July - September	3,310	8.00
	October	3,674	7.36
	November	4,101	7.74
	December	4,357	7.17
	October - December	4,044	7.42

1) Daily average figures

Table 27
Discount Rates on Rupiah Certificate of Deposits by Group of Banks [1)]
(percent per annum)

Maturity	2000	2001	2002				2003			
	December	December	March	June	September	December	March	June	September	December
State banks										
1 -month	12.04	16.48	16.19	13.99	13.29	12.91	11.74	11.00	7.71	6.60
3 -months	12.95	17.51	17.19	16.58	14.34	13.26	12.85	11.79	9.10	7.05
6 -months	11.62	14.25	17.49	17.12	15.30	15.06	12.79	12.71	9.54	7.43
12 -months	11.66	16.03	16.18	16.16	15.81	14.72	13.86	13.31	13.14	11.46
24 -months	11.50	16.28	16.29	16.33	16.83	15.05	15.20	14.03	13.00	13.00
Private national banks										
1 -month	12.59	17.28	17.11	15.85	14.52	13.76	12.93	11.33	8.26	6.48
3 -months	11.81	16.81	17.07	16.28	15.25	13.75	13.25	11.92	9.64	7.03
6 -months	13.24	15.77	16.69	17.01	16.08	15.24	13.82	13.52	10.53	9.01
12 -months	12.12	17.62	17.44	17.45	13.97	14.65	13.07	12.97	12.74	13.40
24 -months	-	-	-	-	-	-	14.11		14.11	
Regional government banks										
1 -month	11.26	15.85	16.38	14.98	14.00	12.16	11.26	9.36	7.51	6.26
3 -months	13.88	18.19	18.09	16.92	15.03	14.23	14.19	11.63	8.58	7.14
6 -months	12.00	-	-	-	15.00	15.00	15.00	15.00		
12 -months	13.81	13.00	15.46	15.92	14.77	15.68	15.62	11.02	10.18	11.00
24 -months	-	-	-	-	-	-				
Foreign banks and joint banks										
1 -month	9.43	11.90	-	-	-	-	-	-	-	-
3 -months	9.70	13.78	-	-	-	-	-	-	-	-
6 -months	8.28	10.24	-	-	-	-	-	-	-	-
12 -months	7.90	8.40	-	-	-	-	-	-	-	-
24 -months	-	-	-	-	-	-	-	-	-	-
Commercial banks										
1 -month	12.47	16.81	16.75	15.73	14.45	13.57	12.71	11.06	8.09	6.46
3 -months	11.83	16.97	17.12	16.41	14.99	13.67	13.20	11.89	9.52	7.05
6 -months	12.00	14.65	17.39	17.09	15.39	15.07	12.92	12.84	10.32	8.62
12 -months	12.11	16.50	16.52	16.49	15.68	14.72	13.71	13.22	13.01	12.60
24 -months	11.50	16.28	16.29	16.33	16.33	15.05	14.77	14.03	13.03	13.00

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 1999	711,542	691,408	62,899
January - December 2000	928,944	937,212	59,781
January - December 2001	970,380	974,669	55,460[r]
January - December 2002	1,009,912	988,259	77,113
2003			
January	102,873	76,005	103,981
February	93,145	84,981	112,145
March	91,282	84,145	119,282
April	94,601	102,282	111,601
May	100,000	98,498	113,103
June	92,665	83,000	122,768
July	135,390	131,592	126,566
August	105,905	102,968	129,504
September	100,412	97,744	132,172
October	134,085	131,098	135,159
November	58,950	88,704	105,405
December	116,358	116,360	105,402

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
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		
Juni			16.52	16.28		
September			17.65	17.56		
December			17.62	17.63		
2002						
March	-	-	16.76	16.89	-	-
Juni	-	-	15.11	15.18	-	-
September	-	-	13.22	14.11	-	-
December	-	-	13.02	13.12	-	-
2003						
January	-	-	12.69	12.94	-	-
February	-	-	12.24	12.69	-	-
March	-	-	11.40	11.97	-	-
April	-	-	11.06	11.29	-	-
May	-	-	10.44	10.88	-	-
June	-	-	9.53	10.18	-	-
July	-	-	9.10	9.18	-	-
August	-	-	8.91	9.06	-	-
September	-	-	8.66	8.75	-	-
October	-	-	8.48	8.43	-	-
November	-	-	8.49	8.38	-	-
December	-	-	8.31	8.34	-	-

1) Weighted average

Table 30
Money Market Securities (SBPUs) Transactions between Bank Indonesia and Banks
(billions of rupiah)

Period	Buying	Repayment	Outstanding
1999			
January - March	1,018	1,018	1,018
April - June	-	-	1,018
July - September	-	-	1,018
October - December	644	1,662	-
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 - Juni	22	22	0
July - September	0	0	0
October - December	8	8	0
2002			
January - March	0	0	0
April - June	0	0	0
Juli - September	0	0	0
October - December	0	0	0
2003			
January	0	0	0
February	0	0	0
March	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	1999/2000[1]	2000[1]	2001[1]	2002[1]	2003		2004
					Budget[2]	Realization[3]	Budget[2]
Government Revenues and Grants	**187,819**	**205,334**	**301,078**	**298,605**	**336,155**	**341,095**	**349,934**
Domestic revenues	**187,819**	**205,334**	**300,600**	**298,528**	**336,155**	**340,658**	**349,300**
Tax Revenues	**125,951**	**115,912**	**185,541**	**210,088**	**254,140**	**241,628**	**272,175**
Domestic Taxes	**120,915**	**108,884**	**175,974**	**199,512**	**241,742**	**230,550**	**260,224**
Income tax (PPh)	72,729	57,073	94,576	101,874	120,925	114,832	133,968
Non-oil and gas	59,683	38,421	71,474	84,404	106,149	96,051	120,835
Oil and gas	13,046	18,652	23,102	17,469	14,776	18,781	13,133
Value added tax (PPN)	33,087	35,232	55,967	65,153	80,790	76,761	86,273
Land and building tax (PBB)	3,525	5,246	5,924	6,228	7,524	8,763	8,031
Duties on land and building transfer	604	931	1,417	1,600	2,402	2,143	2,668
Excise duties	10,384	11,287	17,394	23,189	27,946	26,396	27,671
Other taxes	611	837	1,384	1,469	2,157	1,654	1,614
International trade taxes	**5,036**	**7,028**	**9,567**	**10,575**	**12,398**	**11,077**	**11,951**
Import duties	4,177	6,697	9,026	10,344	11,960	10,847	11,636
Export tax	859	331	541	231	438	230	315
Non-tax revenues	**61,868**	**89,422**	**115,059**	**88,440**	**82,015**	**99,031**	**77,125**
Natural Resource Revenues	45,435	76,290	85,672	64,755	59,396	67,066	47,241
Oil	0	50,953	58,950	47,686	39,911	42,610	28,248
Gas	0	15,708	22,091	12,325	16,285	18,953	15,754
Other natural resources	0	9,629	4,631	4,744	3,201	5,502	3,238
Mining	0	857	2,320	1,457	1,483	1,985	1,628
Forestry	0	8,719	2,243	3,130	1,268	3,236	1,010
Fishery	0	53	68	157	450	281	600
Profit transfer from SOEs	5,430	4,018	8,837	9,760	10,414	12,614	11,454
Other non-tax revenues (PNBP)	11,002	9,114	20,550	13,925	12,206	19,351	18,430
Grants	**0**	**0**	**478**	**78**	**0**	**437**	**634**
Government Expenditures	**231,879**	**221,467**	**341,563**	**322,180**	**370,592**	**374,764**	**374,351**
Central government expenditures	**201,943**	**188,392**	**260,508**	**223,976**	**253,714**	**254,082**	**255,309**
Routine expenditures	**156,756**	**162,577**	**218,823**	**186,651**	**188,584**	**189,083**	**184,438**
Personnel expenditures	**32,719**	**29,613**	**38,713**	**39,480**	**50,241**	**47,288**	**56,738**
Salaries and pensions	27,010	25,005		31,958	41,437	38,768	46,384
Rice allowances	1,822	1,521		1,393	1,575	1,597	1,719
Food allowances	2,567	2,606		2,707	3,460	3,389	4,433
Other domestic personnel expenditures	1,294	443		2,398	2,230	2,627	2,695
Overseas personnel expenditures	25	38		1,024	1,539	908	1,508
Material expenditures	**10,765**	**9,605**	**9,931**	**12,777**	**15,427**	**13,851**	**17,280**
Domestic	9,784	9,500		12,009	14,236	13,177	16,066
Overseas	980	104		768	1,191	674	1,214
Interest payment	**42,910**	**50,068**	**87,142**	**87,667**	**81,975**	**69,235**	**65,651**
Domestic debt	22,230	31,238	58,197	25,406	55,180	46,356	41,276
Foreign debt	20,679	18,830	28,945	62,261	26,795	22,879	24,375
Subsidies	**65,916**	**62,745**	**77,443**	**43,606**	**25,465**	**43,885**	**26,362**
Fuel	40,923	53,810	68,381	31,162	13,210	30,038	14,527
Non-fuel	24,993	8,936	9,063	12,445	12,255	9,901	10,995
Tax paid by government						3,946	840
Other routine expenditures	**4,446**	**10,546**	**5,594**	**3,119**	**15,476**	**14,824**	**18,407**
Development expenditures	**45,187**	**25,815**	**41,585**	**37,325**	**65,130**	**64,999**	**70,871**
Rupiah financing	20,804	8,845	21,371	25,608	46,230	48,845	50,500
Project aid	24,383	16,970	20,214	11,717	18,900	16,154	20,371
Regional expenditures	**29,936**	**33,075**	**81,054**	**98,204**	**116,878**	**120,683**	**119,042**
Regional balancing funds	**29,936**	**33,075**	**81,054**	**94,657**	**107,491**	**111,418**	**112,187**
Revenue sharing	3,993	4,628	20,008	24,884	27,896	31,757	26,928
General allocation funds	25,943	28,807	60,346	69,159	76,978	76,938	**82,131**
Special allocation funds	0	0	701	613	2,617	2,723	3,128
Special autonomy and equalization funds	**0**	**0**	**0**	**3,548**	**9,387**	**9,265**	**6,855**

1) Audited State Budget (PAN) figures
2) State Budget approved
3) Realization, January 1, 2003 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	1999/2000 1)	2000 1)	2001 1)	2002	2003		2004
					Budget 2)	Realization 3)	Budget 2)
I. Domestic financing	**14,672**	**5,937**	**30,218**	**16,946**	**22,450**	**32,115**	**40,556**
1. Domestic banks (SILPA/SIKPA) 4)	-1,941	-12,964	-1,227	-8,218	8,500	8,258	19,199
2. Non-domestic banks	16,613	18,900	31,445	25,164	13,950	23,857	21,358
a. Privatization	3,727	-	3,465	7,665	8,000	7,301	5,000
b. Asset recovery	12,886	18,900	27,980	19,439	18,000	19,661	5,000
c. Domestic bonds, net	-	-	0	-1,939	-12,050	-3,105	11,358
i. Government bonds	-	-	0	1,991	7,700	11,319	32,500
ii. Domestic debt/bond amortization	-	-	-	-3,931	-19,750	-14,424	-21,142
II. Foreign financing, net	**29,388**	**10,196**	**10,267**	**6,628**	**11,986**	**1,554**	**-16,139**
1. Gross drawing	49,584	17,819	26,152	18,887	29,250	17,652	28,237
Program loan	25,201	849	6,416	7,170	10,350	1,792	8,500
Project loan	24,383	16,970	19,736	11,717	18,900	15,860	19,737
2. Amortization	-20,196	-7,623	-15,885	-12,259	-17,264	-16,098	-44,376
Net financing	**44,060**	**16,133**	**40,485**	**23,574**	**34,436**	**33,669**	**24,418**

1) Audited State Budget (PAN) figures
2) State budget (approved)
3) Realization, up to December 31, 2003 (unaudited)
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 Deposit	Total
	Rupiah	Foreign Currency	Sub-total	Rupiah 2)	Foreign Currency	Sub-total		
1999	68,456	47,110	115,566	301,431	85,640	387,071	122,981	625,618
1999/2000	75,847	46,078	121,925	301,087	86,670	387,757	135,801	645,483
2000	104,539	70,969	175,508	296,885	93,658	390,543	154,328	720,379
2001	120,541	66,478	187,018	348,257	97,940	446,196	172,613	805,827
2002								
March	113,974	63,419	177,393	358,238	94,198	452,436	165,022	794,851
June	119,612	60,044	179,657	362,710	82,686	445,395	171,507	796,559
September	125,567	69,470	195,037	368,091	86,441	454,532	174,814	824,384
December	130,877	73,189	204,067	365,771	81,710	447,480	193,468	845,015
2003								
January	119,374	73,986	193,360	368,901	82,410	451,311	189,590	834,261
February	122,335	71,182	193,517	375,363	80,805	456,168	190,044	839,729
March	126,260	66,929	193,189	377,212	78,037	455,249	190,286	838,724
April	127,769	66,653	194,422	377,283	77,368	454,651	193,697	842,770
May	127,668	70,796	198,464	374,352	73,485	447,837	197,770	844,071
June	138,237	65,625	203,862	370,170	74,620	444,790	202,421	851,073
July	138,708	66,676	205,384	371,030	74,942	445,972	204,809	856,165
August	143,063	66,881	209,944	366,837	74,444	441,281	209,877	861,102
September	148,122	70,897	219,019	359,810	74,040	433,850	213,410	866,279
October	153,210	70,777	223,987	363,907	74,317	438,224	219,528	881,739
November	142,455	69,839	212,294	360,758	78,455	439,213	226,325	877,832
December	155,898	68,861	224,759	356,287	76,840	433,127	244,440	902,326

1) Including deposits owned by the Central Government and non-residents
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			Total		
	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
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
1999/2000	28,859	12,539	41,398	32,432	14,695	47,127	5,412	16	5,428	9,144	18,828	27,972	75,847	46,078	121,925
2000	49,205	24,284	73,489	34,123	18,973	53,096	10,806	7	10,823	10,405	27,695	38,100	104,539	70,969	175,508
2001	50,956	14,430	65,386	38,099	24,270	62,369	22,775	21	22,797	8,710	27,756	36,466	120,541	66,478	187,018
2002															
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
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
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
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
2003															
January	45,462	22,226	67,688	39,527	25,635	65,162	24,349	26	24,375	10,036	26,099	36,135	119,374	73,986	193,360
February	46,436	19,194	65,630	39,512	25,129	64,641	26,368	27	26,395	10,019	26,832	36,851	122,335	71,182	193,517
March	48,396	17,407	65,803	39,714	25,045	64,759	27,227	26	27,253	10,923	24,451	35,374	126,260	66,929	193,189
April	49,582	16,077	65,659	40,356	26,008	66,364	27,842	42	27,884	9,989	24,526	34,515	127,769	66,653	194,422
May	51,968	18,439	70,407	40,257	25,899	66,156	26,648	42	26,690	8,795	26,416	35,211	127,668	70,796	198,464
June	55,513	16,524	72,037	43,544	25,610	69,154	29,071	41	29,112	10,109	23,450	33,559	138,237	65,625	203,862
July	54,250	17,158	71,408	44,064	25,949	70,013	28,933	45	28,978	11,461	23,524	34,985	138,708	66,676	205,384
August	57,883	17,929	75,812	44,224	25,525	69,749	30,988	271	31,259	9,968	23,156	33,124	143,063	66,881	209,944
September	59,129	21,133	80,262	47,502	26,125	73,627	30,591	32	30,623	10,900	23,607	34,507	148,122	70,897	219,019
October	60,196	20,572	80,768	50,241	26,089	76,330	30,700	32	30,732	12,073	24,084	36,157	153,210	70,777	223,987
November	58,558	20,090	78,648	47,164	26,281	73,445	26,635	30	26,665	10,098	23,438	33,536	142,455	69,839	212,294
December	64,181	17,290	81,471	53,401	27,180	80,581	27,081	40	27,121	11,235	24,351	35,586	155,898	68,861	224,759

Table 35
Commercial Banks' Time Deposits in Rupiah and Foreign Currency by Maturity
(billions of rupiah)

End of Period	24-months	12-months	6-months	3-months	1-month[1)]	Others	Total
1999	436	14,742	35,244	42,125	243,645	50,879	387,071
1999/2000	628	12,992	45,123	55,711	231,854	41,449	387,757
2000	14,061	6,920	23,503	68,877	215,532	61,649	390,542
2001	18,882	13,533	17,903	77,768	242,685	75,425	446,196
2002							
March	20,509	17,506	16,292	84,209	240,515	73,405	452,436
June	21,625	21,108	19,071	78,35	240,985	64,250	445,395
September	21,275	22,740	21,277	73,443	250,739	65,059	454,532
December	21,447	23,161	20,131	77,078	248,834	56,830	447,480
2003							
January	17,026	22,943	18,801	73,937	248,886	69,715	451,308
February	21,563	25,079	20,626	76,418	260,738	51,746	456,170
March	21,555	27,079	21,577	76,914	252,207	55,918	455,250
April	21,342	27,512	22,608	75,210	254,896	53,085	454,653
May	21,450	28,148	24,798	72,298	244,900	56,245	447,839
June	21,226	29,252	26,970	69,747	242,746	54,850	444,791
July	23,428	28,270	28,232	66,748	239,649	59,646	445,973
August	22,381	29,639	29,493	63,774	237,808	58,186	441,281
September	21,748	29,300	29,015	62,083	237,809	53,897	433,852
October	17,052	31,724	29,326	64,187	233,084	62,851	438,224
November	12,409	31,707	28,339	64,749	233,604	68,407	439,215
December	9,667	31,735	24,516	66,836	232,283	68,090	433,127

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		
1999	11,268	4,713	11,916	20,463	46,883	20,188	953	173,785	10,165	300,334	1,097	301,431
1999/2000	12,454	3,863	10,844	22,616	48,713	22,329	619	169,245	9,600	300,283	804	301,087
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	7,729	8,761	23,547	13,331	50,718	28,255	893	208,994	2,586	344,812	3,444	348,257
2002												
March	8,721	8,520	24,531	17,444	50,670	29,634	965	212,536	2,526	355,547	2,690	358,238
June	10,879	9,617	24,519	15,687	53,550	31,206	967	211,798	2,157	360,380	2,330	362,710
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
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
2003												
January	10,072	8,252	27,323	14,173	55,687	32,090	1,241	217,031	663	366,532	2,369	368,901
February	11,396	8,053	27,898	15,448	57,573	32,995	1,377	217,561	743	373,044	2,319	375,363
March	12,471	8,446	30,011	14,794	56,601	34,106	1,207	216,697	282	374,615	2,311	376,926
April	13,204	7,836	28,655	16,205	56,336	34,719	1,113	216,319	305	374,692	2,339	377,031
May	12,612	7,879	28,790	14,857	57,072	35,109	1,135	214,109	642	372,205	2,149	374,354
June	13,994	8,577	29,158	13,402	56,383	34,813	1,013	210,224	482	368,046	2,125	370,171
July	13,693	8,238	30,021	13,861	60,149	34,824	1,122	206,429	575	368,912	2,119	371,031
August	12,844	7,833	30,297	12,884	62,414	34,816	1,119	201,463	1,018	364,688	2,147	366,835
September	12,842	7,533	30,507	13,097	60,303	34,731	1,149	197,017	667	357,846	1,965	359,811
October	12,313	7,929	30,735	12,989	61,326	33,173	1,124	201,445	853	361,887	2,020	363,907
November	10,221	8,829	26,148	11,927	62,457	32,406	1,054	204,938	651	358,631	2,129	360,760
December	7,226	8,040	27,078	10,157	59,461	31,540	1,181	208,333	1,030	354,046	2,243	356,289

Table 37
Certificate of Deposits
(billions of rupiah)

End of period	State Banks	Non-State Banks	T o t al
1999	**491**	**2,156**	**2,647**
1999/2000	**279**	**2,715**	**2,994**
2000	**410**	**3,215**	**3,625**
2001	**2,719**	**2,882**	**5,601**
2002			
March	3,322	2,549	5,871
June	2,067	1,826	3,894
September	1,960	1,574	3,534
December	1,768	1,397	3,165
2003			
January	1,252	1,377	2,629
February	1,179	1,356	2,535
March	1,129	1,466	2,595
April	1,071	1,189	2,260
May	1,043	1,286	2,329
June	983	1,151	2,134
July	444	1,050	1,494
August	387	959	1,346
September	305	956	1,261
October	764	1,263	2,027
November	756	1,223	1,979
December	641	1,165	1,806

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)
1999	66,926	115,945	161	855	17,437	6,181	84,524	122,981
1999/2000	47,607	127,821	196	1532	17,755	6,448	65,558	135,801
2000	65,041	152,388	355	755	1,298	1,185	66,694	154,328
2001	68,138	170,783	510	995	823	834	69,470	172,613
2002								
March	68,247	163,003	445	949	985	1,070	69,677	165,022
June	69,333	168,475	519	1,916	1229	1,116	71,081	171,507
September	69,804	172,856	559	933	1232	1,025	71,595	174,814
December	68,010	191,177	750	1,116	1028	1,175	69,789	193,468
2003								
January	68,487	187,161	709	1,086	1,100	1,342	70,296	189,590
February	68,536	187,636	547	1,122	1,152	1,286	70,235	190,043
March	69,069	187,745	463	1,202	1,135	1,339	70,667	190,286
April	69,094	190,541	566	1,647	1,383	1,510	71,043	193,698
May	68,644	193,913	714	2,216	1,460	1,641	70,818	197,769
June	69,408	197,843	628	2,916	1,459	1,660	71,495	202,420
July	70,013	202,146	502	1,123	1,430	1,539	71,945	204,809
August	70,785	207,302	531	1,131	1,272	1,443	72,588	209,876
September	71,324	210,873	511	1,134	1,292	1,403	73,127	213,410
October	70,889	216,836	733	1,292	1,247	1,402	72,869	219,529
November	70,724	223,551	558	1,237	1,363	1,536	72,644	226,324
December	69,370	241,366	761	1,318	1,334	1,756	71,465	244,439

Tabel 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	
		Invesment Capital	Working	Invesment Capital	Working	Invesment Capital	Working	Invesment Capital	Working	Invesment Capital	Working
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		19.15	17.11	20.48	17.76	19.16	19.02	19.09	18.55	19.19	17.90
2002											
	March	18.99	17.31	20.49	17.68	19.51	19.11	19.43	18.31	19.35	18.03
	June	19.12	17.47	20.29	17.84	19.25	19.00	17.89	18.16	19.08	18.11
	September	19.01	17.72	20.21	17.73	18.80	18.73	17.06	17.30	18.74	8.11
	December	18.85	17.50	19.93	17.89	18.21	18.30	15.71	16.09	18.25	17.82
2003											
	January	18.87	17.53	19.91	17.97	18.20	18.22	15.69	16.57	18.26	17.82
	February	18.81	17.60	19.94	17.98	18.19	18.17	15.71	17.00	18.25	17.85
	March	18.80	17.67	20.01	17.93	17.98	18.12	14.90	16.26	18.08	17.85
	April	18.73	17.64	20.00	17.82	17.63	17.94	14.52	15.69	17.87	17.74
	May	18.67	17.59	19.90	17.81	17.47	17.84	14.19	15.67	17.75	17.67
	June	18.43	17.35	19.91	17.89	17.14	17.58	13.40	15.01	17.41	17.43
	July	18.03	16.82	19.76	17.72	16.52	17.27	12.69	14.72	16.88	17.03
	August	17.37	16.49	19.52	17.74	16.03	16.90	12.26	14.28	16.36	16.70
	September	17.16	16.42	19.38	17.76	15.67	16.61	11.89	13.42	16.07	16.53
	October	16.86	16.16	19.23	17.73	15.34	16.33	11.53	13.25	15.77	16.27
	November	16.52	15.64	19.21	17.63	15.16	16.16	11.17	12.76	15.45	15.93
	December	16.18	15.54	19.08	17.20	14.66	15.75	11.02	12.60	15.07	15.68

1) Weighted average

Tabel 40
Commercial Banks' Credits in Rupiah and Foreign Currency by Economic Sector[1)]
(billions of rupiah)

Description	1999	2000	2001	2002	2003			
					March	June	September	December
Credit in rupiah	**140,527**	**152,482**	**202,618**	**271,851**	**280,773**	**299,664**	**318,818**	**342,026**
Agriculture	21,139	15,028	16,851	19,121	19,456	20,676	21,143	20,759
Mining	879	2,879	890	2,441	2,232	2,797	1,384	1,546
Manufacturing	35,561	35,697	50,434	64,986	62,792	62,241	65,627	67,323
Trade	29,687	30,601	38,491	56,854	60,790	67,798	73,337	74,787
Services	26,332	23,784	30,696	44,581	48,135	51,588	59,864	68,007
Others	26,929	44,493	65,256	83,868	87,369	94,565	97,464	109,603
Credit in foreign currency	**84,606**	**116,518**	**104,976**	**95,559**	**95,367**	**90,899**	**92,878**	**95,917**
Agriculture	2,638	4,475	4,012	3,211	3,666	3,253	3,315	3,548
Mining	2,818	3,801	1,918	3,654	3,890	4,580	3,306	3,515
Manufacturing	48,698	71,085	66,091	58,049	55,619	52,062	53,524	55,801
Trade	13,601	13,498	9,959	9,124	9,764	9,811	10,379	9,470
Services	16,829	20,532	18,365	16,402	17,539	16,275	21,527	21,123
Others	22	3,127	4,632	5,119	4,888	4,919	827	2,460
Total	**225,133**	**269,000**	**307,594**	**367,410**	**376,141**	**390,563**	**411,696**	**437,942**
Agriculture	23,777	19,503	20,863	22,332	23,123	23,928	24,458	24,307
Mining	3,697	6,680	2,807	6,095	6,122	7,377	4,690	5,061
Manufacturing	84,259	106,782	116,525	123,035	118,411	114,303	119,151	123,125
Trade	43,288	44,099	48,450	65,978	70,554	77,609	83,716	84,257
Services	43,161	44,316	49,061	60,983	65,674	67,863	81,391	89,129
Others	26,951	47,620	69,888	88,987	92,257	99,484	98,291	112,063

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)

Description	1999	2000	2001	2002	2003			
					March	June	September	December
Working capital credits	**167,442**	**203,724**	**234,128**	**282,486**	**289,029**	**302,789**	**321,099**	**343,627**
Agriculture	12,162	8,693	8,748	10,336	10,222	11,261	12,053	11,703
Mining	2,368	3,796	1,197	2,497	2,401	2,490	2,788	2,951
Manufacturing	61,278	80,572	88,208	89,555	87,155	83,862	88,266	92,045
Trade	36,181	36,318	40,360	55,804	58,738	65,019	69,518	70,147
Services	28,502	26,725	30,360	35,307	38,256	40,673	50,183	54,718
Others	26,951	47,620	65,255	88,987	92,257	99,484	98,291	112,063
Investment credits	**57,691**	**65,276**	**73,466**	**82,924**	**91,496**	**87,774**	**90,598**	**94,316**
Agriculture	11,615	10,810	12,115	11,996	12,976	12,667	12,405	12,604
Mining	1,329	2,884	6,243	3,598	3,496	4,887	1,902	2,110
Manufacturing	22,981	26,210	28,317	31,480	32,023	30,440	30,885	31,080
Trade	7,107	7,781	8,090	10,174	12,498	12,590	14,198	14,110
Services	14,659	17,591	18,701	25,676	30,503	27,190	31,208	34,412
Others	-	-	-	-	-	-	-	-
Total	**225,133**	**269,000**	**307,594**	**365,410**	**380,525**	**390,564**	**411,696**	**437,943**
Agriculture	23,777	19,503	20,863	22,332	23,198	23,928	24,458	24,307
Mining	3,697	6,680	7,440	6,095	5,897	7,377	4,690	5,061
Manufacturing	84,259	106,782	116,525	121,035	119,178	114,303	119,151	123,125
Trade	43,288	44,099	48,450	65,978	71,236	77,609	83,716	84,257
Services	43,161	44,316	49,061	60,983	68,759	67,863	81,391	89,130
Others	26,951	47,620	65,255	88,987	92,257	99,484	98,291	112,063

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 Sector1)
(billions of rupiah)

Description	1999	2000	2001	2002	2003			
					March	June	September	December
1. State banks	**112,288**	**102,061**	**117,104**	**145,984**	**150,876**	**155,847**	**164,392**	**173,154**
Agriculture	15,516	11,209	12,034	13,632	14,196	15,044	15,250	14,988
Mining	1,360	2,522	5,554	4,040	3,919	4,830	2,823	2,951
Manufacturing	38,489	34,878	40,099	48,155	49,024	46,048	48,239	49,923
Trade	21,958	16,431	17,973	24,144	24,626	28,349	31,279	30,270
Services	19,945	16,370	15,537	19,835	21,900	22,101	31,064	30,896
Others	15,020	20,651	25,907	36,178	37,211	39,475	35,739	44,126
2. Private National Bank	**56,012**	**82,425**	**101,871**	**136,981**	**144,026**	**152,497**	**160,736**	**175,082**
Agriculture	5,740	4,987	6,050	6,383	6,609	6,472	6,563	6,857
Mining	371	863	838	1,209	1,335	1,398	1,132	1,416
Manufacturing	14,421	22,914	28,237	34,192	34,119	35,158	36,041	37,433
Trade	13,307	21,656	23,402	33,869	38,022	41,121	43,524	45,464
Services	15,605	17,500	22,160	30,541	31,443	33,420	35,757	42,589
Others	6,568	14,505	21,185	30,787	32,497	34,928	37,719	41,323
3. Regional Development Bank	**6,793**	**10,106**	**15,419**	**21,518**	**22,846**	**25,493**	**28,309**	**29,198**
Agriculture	853	527	536	969	1,046	1,096	1,225	1,113
Mining	18	65	188	121	119	122	22	20
Manufacturing	190	249	257	325	341	414	456	338
Trade	816	1,182	2,108	3,693	4,011	4,596	5,087	4,789
Services	1,376	1,260	1,411	2,562	2,929	3,395	4,490	4,927
Others	3,540	6,823	10,920	13,848	14,400	15,870	17,029	18,011
4. Foreign and Joint Bank	**50,040**	**74,408**	**73,199**	**60,927**	**58,392**	**56,727**	**58,259**	**60,508**
Agriculture	1,668	2,780	2,244	1,348	1,271	1,317	1,420	1,350
Mining	1,948	3,230	860	725	749	1,028	712	674
Manufacturing	31,159	48,741	47,932	38,363	34,927	32,683	34,416	35,430
Trade	7,207	4,830	4,968	4,272	3,894	3,542	3,826	3,734
Services	6,235	9,186	9,952	8,045	9,402	8,947	10,080	10,717
Others	1,823	5,641	7,243	8,174	8,149	9,211	7,804	8,603
5. Total (1 through 4)	**225,133**	**269,000**	**307,594**	**365,410**	**376,141**	**390,563**	**411,696**	**437,942**
Agriculture	23,777	19,503	20,863	22,332	23,123	23,928	24,458	24,308
Mining	3,697	6,680	7,440	6,095	6,122	7,377	4,690	5,061
Manufacturing	84,259	106,782	116,525	121,035	118,411	114,303	119,151	123,124
Trade	43,288	44,099	48,450	65,978	70,554	77,609	83,716	84,257
Services	43,161	44,316	49,061	60,983	65,674	67,863	81,391	89,129
Others	26,951	47,620	65,255	88,987	92,257	99,484	98,291	112,063

1) Excluding inter-bank loans, loans to the Central Government and non-residents, and aid counterpart funds

Table 43
Flow of Banknotes in Bank Indonesia Head Office and Regional Offices
(trillions of rupiah)

Office	1999		2000		2001		2002		2003	
	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow
Jakarta	24.4	47.2	33.2	51.4	34.9	53.7	37.7	62.3	50.4	75.6
Bandung	22.2	17.1	28.0	20.4	37.6	23.7	40.6	26.2	43.4	28.9
Semarang	17.8	13.6	20.2	15.1	25.5	17.4	27.4	19.1	29.9	22.5
Surabaya	23.4	23.9	28.8	28.6	37.9	33.5	40.4	36.8	42.1	39.2
Medan	11.4	12.8	11.5	11.9	15.1	15.3	16.7	17.7	15.0	14.7
Padang	6.5	11.7	7.8	13.1	10.1	14.9	12.1	16.4	14.2	18.5
Makassar	8.7	10.0	10.4	12.4	13.8	14.9	15.1	16.8	15.7	18.1
Banjarmasin	6.1	9.0	7.8	11.2	10.1	13.4	11.4	15.4	13.0	17.0
Total	**120.5**	**145.3**	**147.7**	**164.1**	**185.0**	**186.8**	**201.4**	**210.7**	**223.7**	**234.6**

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	25	63	6	3	2	1	100
Bandung	40	48	7	3	1	1	100
Semarang	52	37	7	2	1	1	100
Surabaya	46	43	6	3	2	1	100
Medan	16	68	10	3	2	1	100
Padang	12	75	9	3	1	1	100
Makassar	22	59	14	3	2	1	100
Banjarmasin	10	74	11	4	1	1	100

Table 45
Flow of Coins in Bank Indonesia Head Office and Regional Offices
(billions of rupiah)

Office	1999		2000		2001		2002		2003	
	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow
Jakarta	2.2	117.7	4.1	184.5	0.1	196.9	0.6	187.7	4.2	203.4
Bandung	11.1	14.8	15.2	21.0	16.5	28.5	24.9	25.6	69.0	26.4
Semarang	12.2	13.2	14.3	14.4	17.0	15.6	20.5	12.9	44.5	11.5
Surabaya	2.2	29.7	1.8	33.5	4.0	44.2	2.5	50.0	8.2	60.2
Medan	1.1	13.1	0.4	14.0	0.7	24.1	1.0	24.9	2.1	24.0
Padang	0.3	9.7	0.3	12.3	0.5	21.8	0.5	24.8	0.4	23.9
Makassar	0.6	11.2	1.1	10.9	0.5	20.8	0.8	16.5	2.1	19.0
Banjarmasin	0.6	11.4	1.4	11.0	0.8	15.6	0.6	19.6	0.4	23.6
Total	**30.3**	**220.8**	**38.6**	**301.6**	**40.1**	**367.5**	**51.4**	**362.0**	**131.0**	**391.9**

Tale 46
World Economic Growth
(percent)

Countries	1999r	2000r	2001r	2002r	2003*
World	**3.6**	**4.8**	**2.4**	**3.0**	**3.2**
Industrial countries	**3.4**	**3.9**	**1.0**	**1.8**	**1.8**
7 major industrial countries	3.0	3.5	0.8	1.6	1.8
United States	4.1	3.8	0.3	2.4	2.6
Japan	0.2	2.8	0.4	0.2	2.0
Germany	2.0	2.9	0.8	0.2	n.a.
France	3.2	4.2	2.1	1.2	0.5
Italy	1.7	3.1	1.8	0.4	0.4
United Kingdom	2.4	3.1	2.1	1.9	1.7
Canada	5.5	5.3	1.9	3.3	1.9
Others	4.8	5.1	1.6	3.0	1.9
Developing countries	**3.9**	**5.7**	**4.1**	**4.6**	**5.0**
Africa	2.7	3.0	3.7	3.1	3.7
Middle East, Malta, and Turkey	0.9	6.0	2.0	4.8	5.1
Latin America	0.2	4.0	0.7	-0.1	1.1
Asia	6.2	6.8	5.8	6.4	6.4
NIEs Asia	8.0	8.4	0.8	4.8	2.3
People's Republic of China	7.1	8.0	7.5	8.0	7.5
Indonesia	0.8	4.9	3.4	3.7	3.5
Singapore	6.4	9.4	-2.4	2.2	0.5
Malaysia	6.1	8.6	0.3	4.1	4.2
Thailand	4.4	4.6	1.9	5.3	5.0
Philippines	3.4	4.4	4.5	4.4	4.0
Vietnam	4.2	5.5	5.0	5.8	6.0
Countries in transition[1)]	**4.1**	**7.1**	**5.1**	**4.2**	**4.9**
Central and Eastern Europe	2.3	3.9	3.1	3.0	3.4
Russia	5.4	9.0	5.0	4.3	6.0
Transcaucasus dan Central Asia	4.6	5.3	-	-	-

1) Excl. Belarus and Ukraine
Sources: – IMF, *World Economic Outlook*
– Bank Indonesia

Table 47
World Inflation Rate
(percent)

Countries	1999r	2000r	2001r	2002r	2003 *
World	**3.0**	**-**	**-**	**-**	**-**
Industrial countries	**1.4**	**2.2**	**2.2**	**1.5**	**1.8**
7 major industrial countries	1.4	2.2	2.0	1.3	1.8
United states	2.2	3.4	2.8	1.6	2.1
Japan	-0.3	-0.9	-0.7	-0.9	-0.3
Germany	0.7	2.1	1.9	1.3	1.0
France	0.6	1.8	1.8	1.9	1.9
Italy	1.7	2.6	2.7	2.6	2.8
United Kingdom	2.3	2.1	2.1	2.2	2.8
Canada	1.8	2.7	2.5	2.3	2.8
Others	1.3	2.4	2.9	2.4	2.2
Developing Countries	**6.5**	**5.8**	**5.8**	**5.3**	**5.9**
Africa	12.2	14.3	12.9	9.3	10.6
Middle East, Malta, and Turkey	23.6	19.5	17.1	15.7	13.5
Latin America	7.4	6.8	6.4	8.7	10.9
Asia	2.5	1.8	2.7	2.0	2.5
NIEs Asia	n.a.	1.1	1.9	1.0	1.5
People's Republic of China	-1.4	0.4	0.7	-0.8	0.8
Indonesia	20.70	3.8	11.5	11.9	6.6
Singapore	-4.8	3.5	1.0	-0.4	0.6
Malaysia	2.8	1.6	1.4	1.8	1.7
Thailand	n.a.	1.7	1.5	0.6	1.4
Philippines	6.7	4.3	6.1	3.1	3.0
Vietnam	7.6	-1.7	-0.4	4.0	4.0
Countries in transition[1)]	**44.4**	**20.7**	**16.2**	**11.1**	**9.7**
Central and Eastern Europe	11.0	12.9	9.7	5.6	4.0
Russia	85.7	20.8	20.6	16.0	14.4
Transcaucasus and Central Asia	15.4	14.8	-	-	-

Sources :
- IMF, *World Economic Outlook*, September 2003
- Bank Indonesia
- BPS
- The Economist

Tabel 48
Interest Rates (%) and Exchange Rates

Description	1999r	2000r	2001r	2002r	2003 *
Interest rates in industrial countries					
Short term	3.40	4.40	3.20	2.00	1.80
Long term	4.70	5.00	4.40	4.20	3.70
LIBOR 6 months					
$	5.50	6.60	3.70	1.90	1.30
Yen	0.20	0.30	0.20	0.10	0.10
Euro	3.00	4.60	4.20	3.30	2.20
Exchange Rates					
Yen/$	113.90	107.80	121.50	125.40	118.60
DM/$	1.83	2.12	2.18	-	-
$/GBP	1.62	1.52	1.44	1.50	1.62

Souces :
IMF, *World Economic Outlook*, September 2004

Table 49
World Trade Volume and Price
(annual percent change)

Indicator	1999r	2000r	2001r	2002r	2003 *
Volume	**5.8**	**13.3**	**-0.6**	**3.3**	**2.9**
Price					
Industrial goods	-1.8	-4.7	-2.4	2.6	12.8
Non-oil and gas primary commodities	-6.7	4.5	-4.0	0.6	5.0
O i l	37.5	57.0	-14.0	2.8	14.2

Source :
IMF, *World Economic Outlook*, September 2003

Table 50
Current Accounts in Industrial and Developing Countries
(percent of GDP)

Country	1999r	2000r	2001r	2002r	2003*
7 Major Industrial Countries					
United States	-3.2	-4.2	-3.9	-4.6	-5.1
Japan	2.6	2.5	2.1	2.8	2.9
Germany	-1.1	-1.4	n.a.	2.3	2.4
France	2.9	1.4	1.7	1.8	1.2
Italy	0.7	-0.5	-0.1	-0.6	-1.1
United Kingdom	-2.2	-2.0	-1.3	-0.9	-1.0
Canada	0.3	2.9	2.4	2.0	1.6
Developing Countries					
People's Republic of China	1.6	1.9	1.5	2.8	1.4
Indonesia	4.10	5.3	4.9	4.3	2.7
Singapore	18.7	14.5	19.0	21.5	23.7
Malaysia	15.9	9.4	8.3	7.6	8.2
Thailand	10.2	7.6	5.4	6.0	5.3
Philippines	10.0	11.3	1.8	5.4	2.6

Source :
IMF, *World Economic Outlook*, September 2003

Appendix G

Banknotes Specimen Issued in 2003

Rp 200

Rp 500

Coin Characteristics

No.	Deno-mination	Year	Material	Size (mm)		Weight (gram)	Pictures		Date of Emission
				Diameter	Height		Front	Back	
1	Rp 200.00	2003	Aluminium	25.00	2.30	2.38	Garuda Pancasila	Burung Jalak Bali	November 1, 2003
2	Rp 500.00	2003	Aluminium	27.00	2.30	3.10	Garuda Pancasila	Jasmine	November 1, 2003

Appendix H

Abbreviations

AAOIFI	:	Accounting and Auditing Organization for Islamic Financial Institutions
ABF	:	Asian Bond Fund
ABMI	:	Asian Bond Market Initiatives
ABS	:	Automatic Bidding System
ACD	:	Asian Cooperation Dialogue
ADB	:	Asian Development Bank
AFMM	:	ASEAN Finance Ministers Meeting
AFTA	:	ASEAN Free Trade Area
APBN	:	State Budget
APEC	:	Asia-Pacific Economic Cooperation
API	:	Asset Price Index
API	:	Indonesian Banking Architecture
ASEAN	:	Association of Southeast Asia Nations
ATM	:	Automatic Teller Machine
BAPEPAM	:	Capital Market Supervisory Agency
Bappenas	:	National Planning Board
BBKU	:	Frozen Banks
BBM	:	Fuel (oil)
BBO	:	Frozen Bank
BCA	:	Bank Central Asia
BEER	:	Bilateral Effective Exchange Rate
BES	:	Surabaya Stock Exchange
BG	:	Non-negotiable Payment Order to Account Beneficiary
BI	:	Bank Indonesia
BII	:	Bank International Indonesia
BI-RTGS	:	Bank Indonesia's Real Time Gross Settlement
BIS	:	Bank for International Settlement
BISIP	:	Bank for International Settlement Investment Pool
BKPM	:	Investment Coordinating Board
BKR	:	Credit Bureau – Bank Indonesia
BLBI	:	Bank Indonesia Liquidity Support
BNI	:	Bank Negara Indonesia

BOP	:	Balance of Payments
Botasupal	:	Coordinating Board for Eradication Counterfeit Money
BPK	:	Supreme Audit Board
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
Bulog	:	National Logistic Agency
BUMN	:	State-Owned Enterprises
BUMD	:	Regional State-Owned Enterprises
BUSD	:	Private National Foreign Exchange Bank
BUSN	:	National Private Bank
BUSND	:	Private National Non-foreign Exchange Bank
CA	:	Basel Capital Accord
CAC	:	Collective Action Clause
CAMEL	:	Capital, Asset, Management, Earnings and Liquidity
CAMELS	:	Capital, Asset, Management, Earnings, Liquidity and Sensitivity
CAR	:	Capital Adequacy Ratio
C/D	:	Currency to Deposit
CDMA	:	Code Division Multi Access
CEIC	:	China Economic Information Center
CGI	:	Consultative Group on Indonesia
Cif	:	Cost on Freight
CIP	:	Covered Interest Rate Parity
CMI	:	Chiang Mai Initiative
CNY	:	China Yuan
CPI	:	Consumer Price Index
CPO	:	Crude Palm Oil
CP	:	Core Principles
CP-SIPS	:	Core Principles for Systemically Important Payment System
CR	:	Central Registry
CRC	:	Cold Rolled Coil
CSA	:	Centralized Settlement Account
CTC	:	Counter Terrorism Committee
DAU	:	General Allocation Funds

DBH	:	Profit Sharing Fund
DJIA	:	Dow Jones Industrial Average
DPD	:	Directorate of Reserve Management
DPK	:	Third Party Funds
DPR	:	The House of Representatives
DSR	:	Debt Service Ratio
ECB	:	European Central Bank
EFF	:	Extended Fund Facility
EO	:	Exchange Offer
EU	:	European Union
FASBI	:	Bank Indonesia Deposit Facility
FATF	:	Financial Actions Task Force on Money Laundering
FDI	:	Foreign Direct Investment
FFIT	:	Full Fledged Inflation Targeting
FI	:	Fiscal Impulse
FKSPN	:	National Payment System Communication Forum
Fob	:	free on board
FoP	:	Free of Payment
FPD	:	Contingency Financing Facility
FPJP	:	Short-term Financing Facility
FR	:	Fixed Rate
FSN	:	Financial Safety Net
FSS	:	Financial System Stability
FTA	:	Free Trade Agreement
FXSI	:	Foreign Exchange Transactions and Settlement Issues
GBI	:	Governor of Bank Indonesia
GBP	:	Great Britain Poundsterling
GBHN	:	Broad Outline of the Nation's Direction
GDP	:	Gross Domestic Product
GFA	:	Gross Foreign Asset
GNP	:	Gross National Product
GTZ	:	Gessenschaft fur Technische Zusammenarbeit
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
IC	:	Intercity Clearing
ICA	:	Inter Company/Office Account
ICOR	:	Incremental Capital-Output Ratio
ICS	:	Image Clearing System
IDB	:	Islamic Development Bank
IDR	:	Indonesian Rupiah
IFI	:	International Financial Institution
IFSB	:	Islamic Financial Services Board
IFSN	:	Indonesia's Financial Safety Net
IFSO	:	Islamic Financial Services Organization
IHSG	:	Jakarta Composite Index
IIE	:	Investor Information and Enquiries
IIF	:	Institute of International Finance
IIFM	:	International Islamic Financial Market
IIRA	:	International Islamic Rating Agency
IMF	:	International Monetary Fund
INPRES	:	President Instruction
IPO	:	Initial Public Offering
IRCo	:	International Rubber Consortium
IRFCI	:	International Reserve and Foreign Currency Liquidity
IRO	:	Investor Relation's Office
IRTI	:	Islamic Research and Training Institute
IRU	:	Investor Relation Unit
IT	:	Information Technology
IT	:	Inflation Targeting
ITRCo	:	The International Tripartite Rubber Company
Jabotabek	:	Jakarta-Bogor-Tanggerang-Bekasi Area
JBIC	:	Japan Bank for International Cooperation
JCI	:	Jakarta Composite Index
JETRO	:	Japan External Trade Organization
JITF	:	Jakarta Initiative Task Force
JPY	:	Japanese Yen
JSE	:	Jakarta Stock Exchanges
KBI	:	Bank Indonesia Branch Office
Keppres	:	Presidential Decree

KI	:	Investment Credit
KIM	:	Working Capital Credit
KK	:	Consumption Credit
Kospi	:	Korean Stock Price Index
KPPOD	:	Regional Autonomy Implementation Monitoring Commitment
LC	:	London Club
LDR	:	Loan to Deposit Ratio
LIBOR	:	London Inter Bank Offer Rate
LLD	:	Foreign Exchange Flows
LNG	:	Liquefied Natural Gas
LOI	:	Letter of Intent
LOLR	:	Lender of the Last Resort
LPG	:	Liquefied Petroleum Gas
LPS	:	Depository Guarantee Agency
M1	:	narrow money
M2	:	broad money
mm	:	money multiplier
MA	:	Moving Average
MMBTU	:	Mille Mille British Thermal Unit
MoU	:	Memorandum of Understanding
MOPS	:	Mid Oil Platt's Singapore
MPR	:	People's Consultative Assembly
MPS	:	Market Perception Survey
MYR	:	Malaysian Ringgit
NCB	:	Net Claims on Business Sector
NCG	:	Net Claims on Government
NDA	:	Net Domestic Asset
NIR	:	Net International Reserve
NOI	:	Net Other Items
NOP	:	Net Open Position
NPL	:	Non-Performing Loan
O/N	:	Overnight
ODA	:	Official Development Assistance
OECD	:	Organization for Economic Cooperation and Development
OLAP	:	On Line Analytical Processing
OMO	:	Open Market Operation
OPEC	:	Organization of Petroleum Exporting Countries
OPT	:	Open Market Operation

PAPSI	:	Indonesian Sharia Banking Accounting Guidelines
PBB	:	Land and Building Tax
PBI	:	Bank Indonesia Regulation
PC	:	Paris Club
PCA	:	Prompt Corrective Action
PHP	:	Philippines Peso
PLN	:	State Electricity Enterprise
PLTU	:	Steam Power Plant
PLTA	:	Water Power Plant
PMA	:	Foreign Direct Investment
PMDN	:	Domestic Investment
PNK	:	Paperless Credit Note
PNM	:	Permodalan Nasional Madani
POLDA	:	Indonesian Local Police
POLRI	:	Indonesian National Police
PPATK	:	Center for Reporting and Analysis on Financial Transaction
PPh	:	Income Tax
PPM	:	Post Program Monitoring
PPn	:	Value Added Tax
PPn BM	:	Sales Tax on Luxury Goods
Propenas	:	The National Development Program
PSAK	:	Preparation of Statement of Financial Accounting Standards
PSAKS	:	Preparation of Statement of Financial Accounting Standards for Sharia Bank
PT	:	Company
PTTB	:	Unfit Bank Notes
PUAB	:	Interbank Money Market
PYD	:	Financing Extended
RBS	:	Risk Based Supervision
REER	:	Real Effective Exchange Rate
RIA-fin	:	Roadmap for Integration of ASEAN
Rp	:	Rupiah
S&P	:	Standard and Poor
SARS	:	Severe Acute Respiratory Syndrome
SBA	:	Stand-by Arrangement
SBI	:	Bank Indonesia Certificate
SE	:	Circular Letter
SEACEN	:	Southeast Asian Central Banks
SEAVG	:	Southeast Asian Voting Group

SIBOR	:	Singapore Inter Bank Overnight Rate
SIPS	:	Systematically Important Payment Systems
SKDU	:	Business Survey
SMEs	:	Small and Medium Enterprises
SNA	:	Standardized National Account
SOEs	:	State Owned Enterprises
SPP	:	Market Perceptions Survey
STI	:	Strait Times Index
SUN	:	Government Securities
SUP	:	Government Securities
SWBI	:	Bank Indonesia Wadiah Certificate
Tbk	:	go public
TDL	:	Base Electricity Tariff
TFP	:	Total Factor Productivity
UK	:	United Kingdom
UMKM	:	Micro, Small and Medium Business
US	:	United States
UYD	:	Circulated Currency
VAT	:	Value Added Tax
WPI	:	Wholesale Price Index
WTO	:	World Trade Organization