

INDONESIA REBOUNDS

GINANDJAR KARTASASMITA

The Japan Institute of International Affairs
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Macroeconomic Update

- ❑ Macroeconomic Development
- ❑ Outlook 2007
- ❑ Policy Reform Initiatives

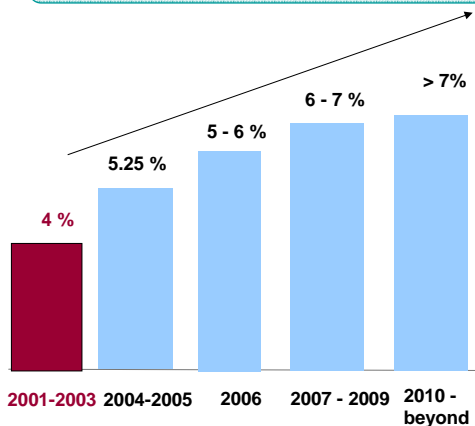
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Positive Growth Trajectory

Sustained economic growth despite difficult environment



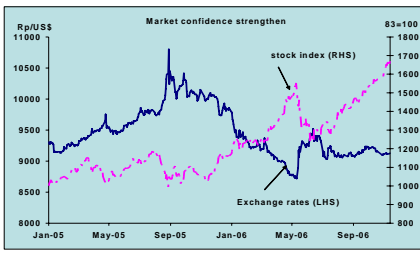
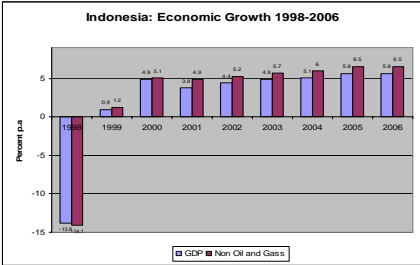
- ❑ Economy is on a steady upward trend. Indonesia's performance is very much comparable in the region
- ❑ Over the medium term, this acceleration process should continue assuming that all reform programs are implemented.

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Macroeconomic Update

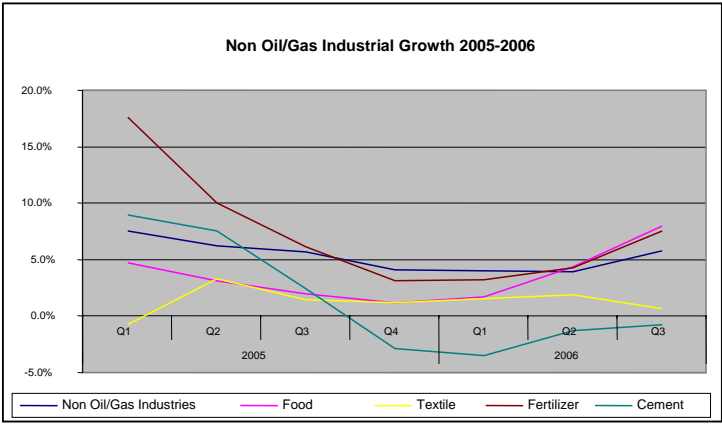


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- **Growth steadily recover**
 - **2006: reached 5.5%; government consumption and export driven; investment remains weak.**
 - **Medium Term**
 - **2007-2009 : 6-7 % p.a**
 - **After 2010 : 7+% % p.a**
- **Confidence has been restored after fuel price adjustment.**
 - **Stock prices are historic high**
 - **Exchange rates are stable**
 - **Reserves stronger and still increasing**
 - **Ratings upgraded.**
- **Macroeconomic Stability has been achieved**
 - **Y o y inflation down from 17% last year to 6.6% or less this year**
 - **Over Medium Term: 3-4% is the target**

Manufacturing sector shows signs of recovery



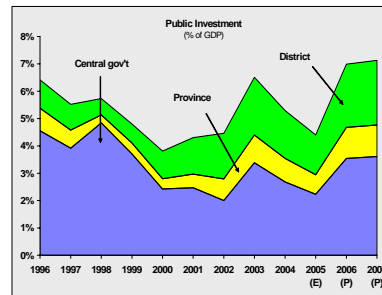
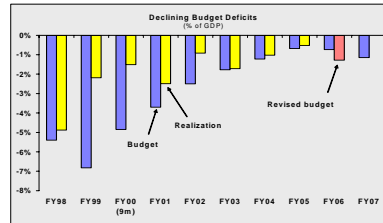
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Other Macroeconomic Development

- **Fiscal sustainability has been reestablished.**
 - Budget deficits has been contained around 1% of GDP
 - public debt ratio down to about 40% at the end of 2006 and will continue falling to below 30% of GDP in 2011.

- **On spending side**
 - Public spending now back to the pre crisis level around 7-8% of GDP but with different composition.
 - Sub-national gov't control more than 50% of total
 - Education spending on the rise and now comparable to the peer countries around 4-5% of GDP
 - Spending on health and infrastructure a also increasing.
 - Commitment for PPP development.



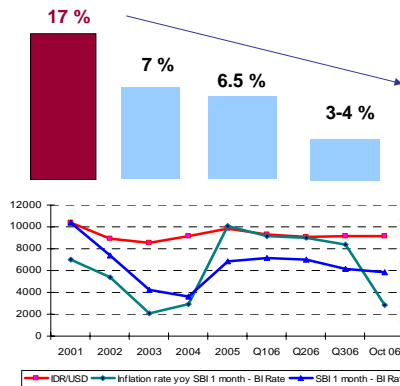
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Sustainable macroeconomic stability

A positive outlook on macroeconomic stability should translate into a reduction of cost of finance



- Stabilization of rupiah at stronger level support declining inflation thus providing room for policy rates to decline.
- CPI inflation : 6.6%
- Inflation easing toward targeted level
- Risks for destabilizing inflation still high: rice price has been increasing since last December.

Source: Bloomberg & BI

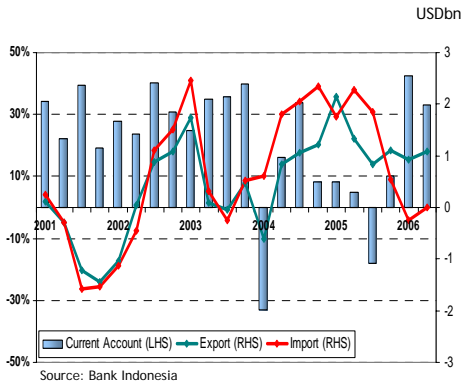
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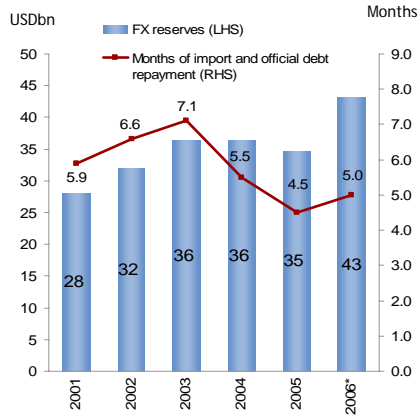
External position remains promising

Current account position has turned around



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Rise in FX reserves



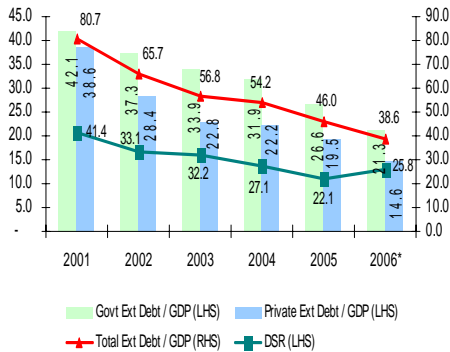
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Continued improvement in external debt position

External Debt

Key highlights



- Debt to GDP ratio decline from 81% in 2001 to 47% in 2005, and expected to reach 39% in 2006.
- There was a significant drop of DSR in 2005 since there was Paris Club moratorium due to tsunami disaster in Aceh.

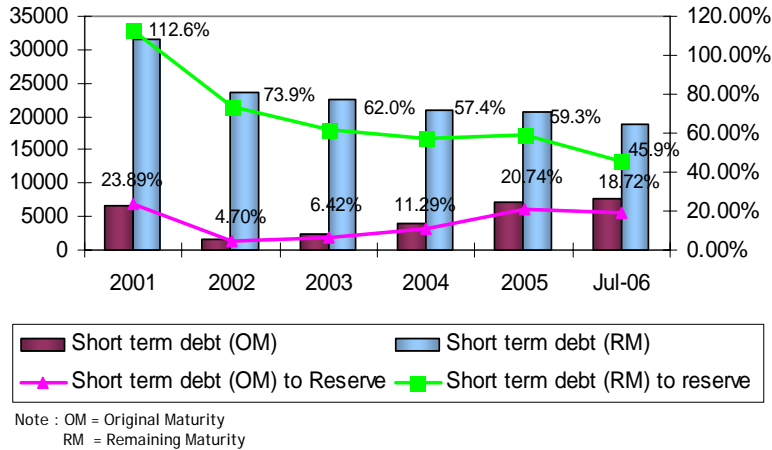
Note : External debt consists of central government, central bank and private debt
Source: Bank Indonesia

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Improving Ratio of Short Term Debt to Reserve



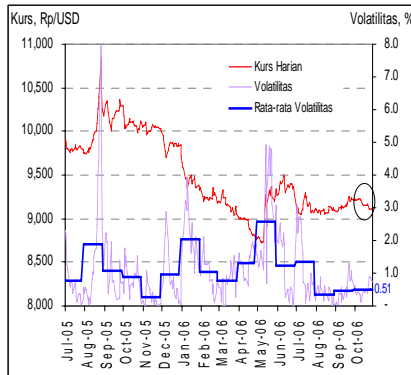
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Exchange rate modest appreciation - low volatility

Average Exchange Rate



— Daily exchange
— Volatility
— Average volatility

Highlights

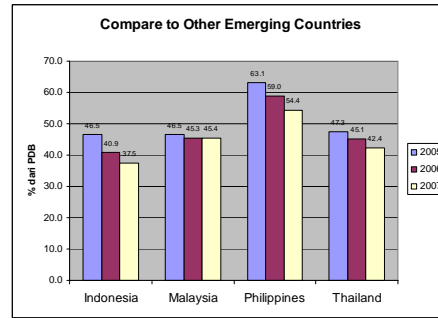
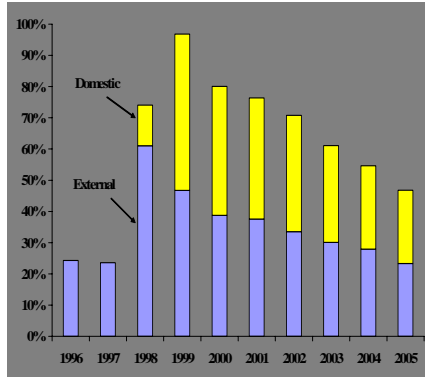
- Rupiah stabilized and average exchange rate during Q3 2006 was Rp. 9,125. Relatively unchanged from Rp. 9,115 in the preceeding quarter
- Average exchange rate in October depreciate 0.26% to Rp. 9174 from Rp 9153
- Volatility stable at 0.5%

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Fiscal Consolidation Outcomes

Sovereign Debt to GDP Ratio



Source: IMF, World Economic Outlook, Sept 2006

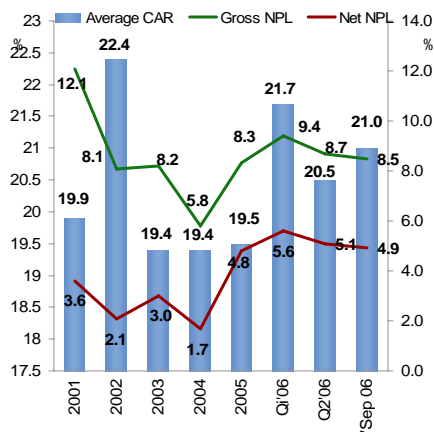
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Banking indicators: Banks maintaining reasonable performance

Main Banking Indicators



Highlights

- NPL ratios decline during the course of 2006
- Banks well capitalized with CAR at around 21% as of August 2006, far above the required level of 8%
- LDR¹ relatively stable during 2006 at around 64-65%. In September 2006 LDR recorded at 65%.
- Net interest income (NII)² in September 2006 was Rp 6.2 trillion, similar to December 2005 figure, despite slowing credit expansion
- RoA stable at around 2.6% with significant rise in total assets.

¹ Loan calculations include channeling loans
² Calculated as NII for the particular month divided by earning assets for the corresponding period

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 Source: Bank Indonesia

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No More IMF and CGI

- ❑ In 2006 Indonesia settled the remaining debt to IMF amounting \$ 7 billion, 4 years ahead.
- ❑ In January 2007, GOI announced the dissolution of CGI.

THE PROBLEMS

- ❑ Macroeconomic development has not been followed by improvements in the microeconomic (real) sectors; major constraint for economic development.
- ❑ Lagging investment.
- ❑ Social Impact : increase of poverty from 16 % to 17.75 % (equivalent to 19.1 million poor households in 2006) and 10.85 million unemployed.
- ❑ Tax Policy.

THE PROBLEMS

- ❑ Manpower: labor law, low income, euphoria of freedom of expression (demonstrations and strikes).
- ❑ Infrastructure: inadequate infrastructure constitute a major constraint to economy as well as social life.
- ❑ Unstable and high oil prices in international markets had given impact to socioeconomic life of the people.
- ❑ Political and security instability impact on economic development, particularly to investment.

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Outlook 2007

| Tabel | | | | |
|-----------------------------------|------|------|------|------|
| Projected Economic Growth | 2004 | 2005 | 2006 | 2007 |
| World Output | 5.3 | 4.9 | 5.1 | 4.9 |
| Developed Countries | 3.2 | 2.6 | 3.1 | 2.7 |
| US | 3.9 | 3.2 | 3.4 | 2.9 |
| Jepang | 2.3 | 2.6 | 2.7 | 2.1 |
| Euro Area | 2.1 | 1.3 | 2.4 | 2 |
| Asia | 8.8 | 9 | 8.7 | 10 |
| China | 8 | 8.5 | 8.3 | 7.3 |
| India | 5.8 | 5.1 | 5 | 5.6 |
| Asean-4 | 5.5 | 5.7 | 5.8 | 5.4 |
| World Trade Volume | 10.6 | 7.4 | 8.9 | 7.6 |
| Impor | | | | |
| Developed Countries | 9.1 | 6 | 7.5 | 6 |
| Expor | | | | |
| Developed Countries | 8.8 | 5.5 | 8 | 6 |
| Inflation | | | | |
| Developed Countries | 2 | 2.3 | 2.6 | 2.3 |
| Emerging and Developing Countries | 5.6 | 5.3 | 5.2 | 5 |
| LIBOR | | | | |
| on USD | 1.8 | 3.9 | 5.4 | 5.5 |
| on Yen | 0.1 | 0.1 | 0.5 | 1.1 |
| on Euro Deposit | 2.1 | 2.2 | 3.1 | 3.7 |
| Source: IMF | | | | |

- Global economy slowing down
- Domestic demand should be the driver for economic growth
 - Public investment and private investment
 - Private consumption

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Outlook 2007

- ❑ Economic Growth: 6 – 6,5% (Budget: 6.3%; Consensus around 6 %)
- ❑ Inflation: 6-7%
- ❑ Policy Rate: 8-9,5% (Budget: 8,5% in current pace; policy rate to go down to becomes 7,5% at the end of 2007); a stimulus for reducing bank's lending rate.

Outlook 2007

- ❑ The problem of purchasing power can be compensated in 2007 by: increase of civil servant's salary, minimum wage, consumption credits, good control of inflation and lending rate by Bank Indonesia.
- ❑ The goal of economic development for 2007: reducing unemployment to 9.9 % and number of poor people to 16,4 %.

Three Policy Packages

| | | |
|--------------------------------|----|---|
| Investment Climate Improvement | 1 | Investment Law & Procedure |
| | 2 | Tax & Custom Reform |
| | 3 | Labor & Immigration |
| | 4 | Trade Licenses |
| Infrastructure | 5 | Cross Sector Strategic Policy Reform |
| | 6 | Sector Restructuring, Corporatisation and Policy Reform |
| | 7 | Regulation on monopoly & investment protection |
| | 8 | Clear separation on the role of policy maker, regulator, contracting agency, and operator |
| Financial | 9 | Coordination Monetary & Fiscal Authority |
| | 10 | Financial Institution (Banking & Non Banking) |
| | 11 | Capital Market and SOE Privatization |

New Reform Packages and Special Programs

- **SME Policy Reform Package**
 - Focus on particularly four areas:
 - Access to Finance
 - Access to Market
 - Human Resource Development and Entrepreneurship
 - Regulatory Reform and Deregulation
- **Poverty Reduction Program**
 - Focus 1: Mainstreaming Budget for Poverty
 - Focus 2: Integration and expansion of KDP (Kecamatan Development Program) and P2KP (Urban Poor) into PNPM (National Program on Community Empowerment)
 - Focus 3: Shifting Cash Transfer to Conditional Cash Transfer
 - Focus 4: Others like Biofuel, Housing and Rural Infrastructures
- **Crash Program for Electricity Expansion**
- **Crash Program for Energy Conversion**
 - LPG for Kerosene
 - Gas for Gasoline
 - Coal and Gas for Power Generation
 - Bioenergy



Note : KDP = Kecamatan Development Program
 P2KP = Program Penanganan Kemiskinan Perkotaan
 PNPM= Program Nasional Pemberdayaan masyarakat.

Investment Policies

- ❑ New Investment Law is being finalized in the Parliament.
- ❑ Streamlining investment procedures.
- ❑ Equal treatment of foreign and domestic investment.
- ❑ Less negative list.
- ❑ More incentive to invest.

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SOCIO-POLITICAL DEVELOPMENT

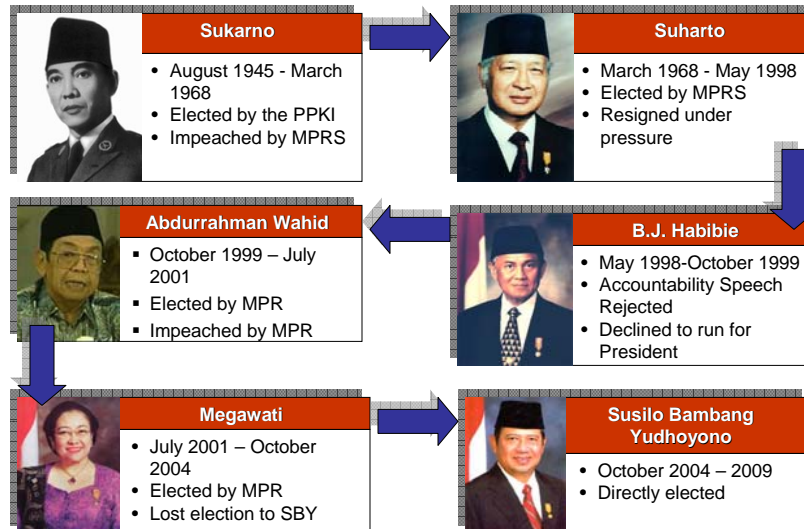
- ❑ Indonesia is emerging from long period of authoritarian rule to consolidate its status as one of the world's largest democratic country.

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Regime Change in Indonesia



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SOCIO-POLITICAL DEVELOPMENT

- ❑ Indonesia's political and economic development after the REFORMASI (1998) seems to be on the right track.
- ❑ Socio-political development: amendment of 1945 Constitution, improvement of checks and balances system, direct presidential and regional executives elections, legal reform and decentralization, human rights, freedom of the press, bigger role of civil society.
- ❑ Peace in Aceh.

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MAJOR PROBLEMS

1. **Institutions:** ambiguity between presidential and parliamentary systems; weak bicameral parliamentary system, establishment of quasi-government institutions, and confusion of role and function in the judicial branch of government.
2. **Political ethics and behavior:** institutionalization of political acts versus personification of political figures; money politics, manipulation of masses.

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MAJOR PROBLEMS

3. Major problems in governance includes
 - ❑ Reform of the bureaucracy
 - ❑ quality of civil servants
 - ❑ corruption
 - ❑ inefficiency
 - ❑ low salary
 - ❑ Impact of problems in bureaucracy on socio-economic domains.

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MAJOR PROBLEMS

- 4. Ethno-nationalism:** as negative impact of decentralization and political freedom (euphoria: from autonomy to special autonomy to independence?)

MAJOR PROBLEMS

- ❑ **Political trust and social trust:** problem in law enforcement (frequently constrained by issues of human rights and freedom of expression).
- ❑ **Pluralism:** negative impact of pluralism in the form of horizontal conflicts along religious, ethnics, socio-economic divide.
- ❑ **Terrorism.**

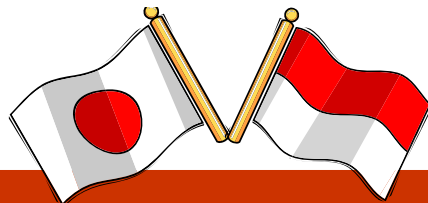
MAJOR PROBLEMS

5. **Major ecological problems:** Tsunami, earthquakes, volcanic eruptions, mud eruptions, deforestation, illegal logging, forest fires, floods and landslides
6. **Major health problems:** avian flu and dengue fever

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Japan-Indonesia Relationship

- ❑ Japan is a traditional and natural economic partner and political ally of Indonesia. Good relation and mutual interest between the two countries have to be maintained.
- ❑ Generally Japanese people and the Japanese Business Community are “losing interests” in Indonesia, giving more attention to China and India.

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The Current State of Economic Cooperation

□ Trade

| Year | Indonesia's Export to Japan | Indonesia's Import from Japan | Surplus |
|----------------|-----------------------------|-------------------------------|-------------------|
| 2005 | US\$ 20.8 billion | US\$ 9.2 billion | US\$ 11.6 billion |
| 2006 (Jan-Dec) | US\$ 23.9 billion | US\$ 7.3 billion | US\$ 16.6 billion |

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The Current State of Economic Cooperation . . .

□ ODA

- Almost 40% of Indonesia's ODA comes from Japan:
 - Economic } Sectors
 - Social }
 - Institutional Capacity Building
 - Technology

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The Current State of Economic Cooperation . . .

Investment

- Japan is still the biggest investor in Indonesia among 103 countries with US\$ 39 billion in 1.715 projects (13% of the total FDI) up to June 2006.

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Changes for Promising Countries/Regions over the Medium-term

| Rank | FY2006 Survey | No. of Companies (%) | FY2005 Survey | No. of Companies (%) | FY2004 Survey | No. of Companies (%) | FY2003 Survey | No. of Companies (%) | FY2002 Survey | No. of Companies (%) |
|------|----------------|----------------------|------------------|----------------------|------------------|----------------------|------------------|----------------------|------------------|----------------------|
| | | 484 | | 483 | | | | 490 | | 418 |
| 1 | China | 372 | 77 China | 397 | 82 China | 453 | 91 China | 456 | 93 China | 373 |
| 2 | India | 229 | 47 India | 174 | 36 Thailand | 151 | 30 Thailand | 143 | 29 Thailand | 118 |
| 3 | Vietnam | 159 | 33 Thailand | 149 | 31 India | 117 | 24 U.S. | 106 | 22 U.S. | 108 |
| 4 | Thailand | 142 | 29 Vietnam | 131 | 27 Vietnam | 110 | 22 Vietnam | 88 | 18 Indonesia | 63 |
| 5 | U.S. | 104 | 21 U.S. | 96 | 20 U.S. | 100 | 20 India | 70 | 14 Vietnam | 62 |
| 6 | Russia | 98 | 20 Russia | 62 | 13 Russia | 49 | 10 Indonesia | 63 | 13 India | 54 |
| 7 | Brazil | 45 | 9 Korea | 52 | 11 Indonesia | 48 | 10 Korea | 44 | 9 Korea | 34 |
| 8 | Korea | 44 | 8 Indonesia | 45 | 9 Korea | 44 | 9 Taiwan | 35 | 7 Taiwan | 34 |
| 9 | Indonesia | 39 | 7 Brazil | 36 | 7 Taiwan | 41 | 8 Malaysia | 31 | 6 Malaysia | 33 |
| 10 | Taiwan | 27 | 6 Taiwan | 32 | 7 Malaysia | 28 | 6 Russia | 25 | 5 Brazil | 19 |
| 11 | Malaysia | 22 | 5 Malaysia | 23 | 5 Singapore | 17 | 3 Singapore | 23 | 5 Singapore | 18 |
| 12 | Germany | 15 | 3 Mexico | 16 | 3 Germany | 17 | 3 Philippines | 18 | 4 Philippines | 17 |
| 13 | Poland | 15 | 3 Germany | 14 | 3 Brazil | 16 | 3 Czech Republic | 17 | 3 Germany | 16 |
| 14 | Czech Republic | 15 | 3 Philippines | 13 | 3 Philippines | 15 | 3 Hong Kong | 15 | 3 Mexico | 15 |
| 15 | Mexico | 14 | 3 Singapore | 12 | 2 France | 15 | 3 Mexico | 12 | 2 Czech Republic | 13 |
| 16 | Philippines | 12 | 2 Czech Republic | 12 | 2 Czech Republic | 12 | 2 Brazil | 11 | 2 U.K. | 11 |
| 17 | U.K. | 12 | 2 U.K. | 9 | 2 Australia | 11 | 2 Germany | 11 | 2 Russia | 11 |
| 18 | Hungary | 8 | 2 Poland | 9 | 2 Poland | 10 | 2 France | 10 | 2 Poland | 10 |
| 19 | Canada | 6 | 1 France | 8 | 2 Mexico | 9 | 2 Australia | 9 | 2 Hong Kong | 9 |
| 20 | Australia | 6 | 1 Australia | 8 | 2 U.K. | 9 | 2 Poland | 9 | 2 Hungary | 9 |

Note: "Medium-term" means the next 3 years or so.

Source: JBEC Institute, Dec 2006

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Milestones for Enhanced Cooperation

Indonesia-Japan Strategic Investment Action Plan (SIAP)

- At the meeting between Prime Minister Junichiro Koizumi and President Susilo Bambang Yudhoyono on 2 June 2005, the two leaders announced the Japan-Indonesia Strategic Investment Action Plan (SIAP).
- This was an initiative to promote foreign investment in Indonesia based on the shared recognition that a substantial increase in foreign investment is essential for poverty reduction and employment generation, and that increased investment from Japan to Indonesia is an important challenge also for revitalization of the Japanese economy.
- SIAP is composed of 118 action items in 5 sectors, namely, tax, customs, labor, infrastructures, industrial competitiveness/small and medium enterprises.

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Milestones for Enhanced Cooperation . . .

- The significance of the November 2006 visit of President Susilo Bambang Yudhoyono to Japan:
 - Signing of the Strategic Partnership for Peaceful and Prosperous Future.
 - Signing of the Principles of Economic Partnership Agreement (EPA).

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Indonesia-Japan Economic Partnership Agreement (IJ-EPA)

- a. Trade in Goods (Tariff and Non-Tariff Measures, Rules of Origin, Trade Remedies).
- b. Trade in Services.
- c. Customs Procedures.
- d. Investment.
- e. Movement of Natural Persons.
- f. Energy and Mineral Resources.
- g. IPR.
- h. Government Procurement.
- i. Competition Policy.
- j. Improvement of Business Environment and Promotion of Business Confidence.
- k. Cooperation

Political Cooperation

- Bilateral.
- Regional.
- Multilateral.

Momentum of the 50th Anniversary of Indonesia-Japan Diplomatic Relations 2008

- ❑ Broadening and deepening exchanges and cross generational mutual understanding.
- ❑ Milestone for a more advanced and mature bilateral relations.
- ❑ Contribution to peace, stability and economic growth on the East Asia region.

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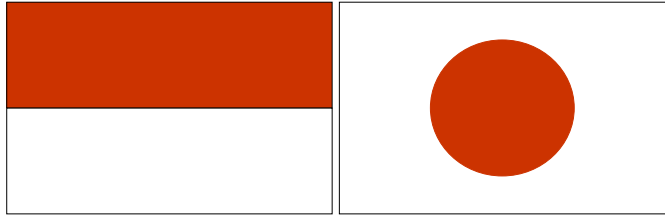
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