The Awakening Garuda: Indonesian Economy 2011

BANK INDONESIA

THE INAUGURAL ISIS PRAXIS SEMINAR 2011

3 March 2011
Renaissance Hotel, Kuala Lumpur

Executive Summary

- **The economy continues to chart strong growth** which recorded at 6.1%, much higher than previous year (4.55) for the whole 2010.
- **On the price level, CPI inflation reached the level of 7.02% (yoy) for January 2010.** mainly due to further steep increases in volatile food prices, and in addition to the escalating prices for globally-traded commodities.
- **External vulnerabilities continue to decline** as Indonesia builds-up comfortable buffers on the back of continuing surge of capital inflows. BoP figrues released earlier this week shows that **for the whole 2010, the overall balance of payments surplus reached US$30.3 billion**, increased considerably from the surplus in the preceeding year. The capital & financial account posted a surplus of US$26,2 billion, more than five fold of surplus in the previous year, whereas current account recorded a smaller surplus.

Executive Summary

- Supported by continued positive international perception, improved business environment, macroeconomic stability and higher credit ratings, FDI is expected to continue accelerating. Cumulatively, **for 2010 the total investment realization figure was recorded at Rp208.5 trillion, a 54.2% increase compared to the 2009 figure** and exceeded by 30.2% of 2010 original target at Rp160.1 trillion.
- On the fiscal front, **Indonesia continue to perform a prudent fiscal management in 2011,** with strong commitment to fiscal consolidation, aiming on:
  - continue declining debt-to-GDP ratio
  - diversifying government debt profile,
  - reducing funding reliance on international capital market.

Improving International Perception: Acknowledged by Rating Agencies

Resilient economy, which impressively navigates through the global crisis and continued confidence in economic outlook, the Republic continued to receive good reviews which already upgraded by Moody's in the beginning of 2011

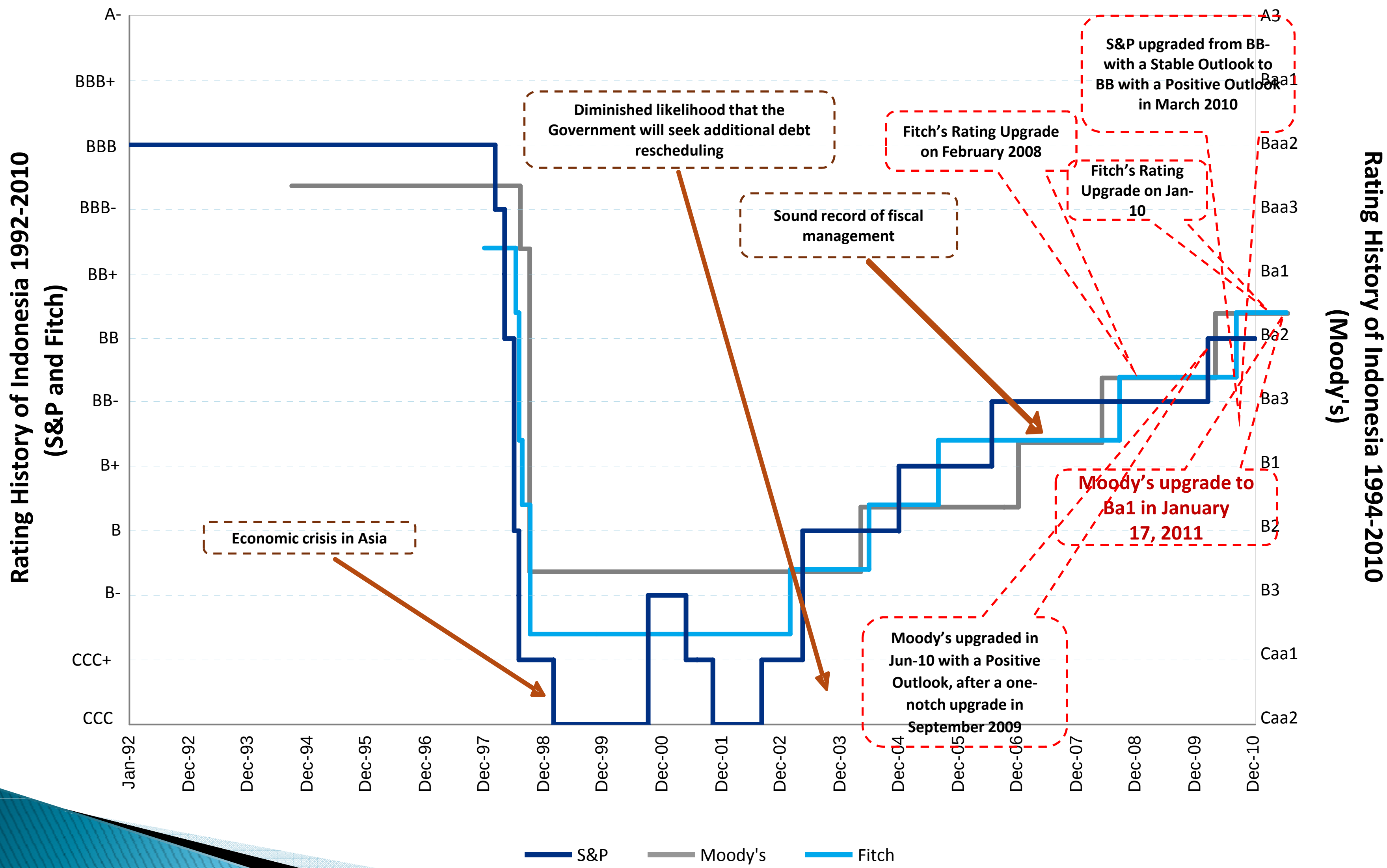
•**Moody's Investors Service (January 17, 2010): upgraded Republic of Indonesia's foreign and local-currency bond ratings to Ba1 with stable outlook.** This follows Moody's release last December which placed the ratings on a review for possible upgrade. The key factors supporting this action were (1) economic resilience which accompanied by sustained macroeconomic balance; (2) Improved government's debt position and central bank's foreign currency reserve adequacy; and (3) Improved prospects for foreign direct investment inflows which expected to fortify Indonesia's external position and economic outlook.

•**Japan Credit Rating Agency, Ltd (July 13, 2010): upgraded Indonesia's sovereign rating to Investment Grade from BB+ to BBB- with stable outlook.** The first upgrade to reach investment grade in the last 13 years reflects enhanced political and social stability, sustainable economic growth , alleviated public debt burden as a result of prudent fiscal management, reinforced resilience to external shocks stemming from the foreign reserves accumulation and an improved capacity for external debt management and efforts made by the current administration to outline the framework to deal with structural issues such as infrastructure development.

•**S & P (March 12, 2010): upgraded Indonesia's long-term foreign currency rating to BB from BB- with positive outlook** which indicates that Indonesia has big possibility to be upgraded within a year, even maybe faster. The main factor supporting this decision is steadily improving debt metrics and growing foreign currency reserves which reduced vulnerability to shock with continued cautious fiscal management.

•**Fitch Ratings (January 25, 2010): upgraded the Republic of Indonesia's sovereign rating to 'BB+' from 'BB' with stable outlook** The rating action reflects Indonesia's relative resilience to the severe global financial stress test of 2008-2009 which has been underpinned by continued improvements in the country's public finances.

Sovereign Rating History



Fitch Revised Indonesia's Outlook to Positive; Affirms at 'BB+' 24 February 2011

Andrew Colquhoun :

- *Indonesia's favourable macroeconomic prospects are likely to see the credit profile strengthen further over the next twelve to eighteen months, despite near-term risks from inflation and potentially volatile capital flows*
- "**Faster progress** in tackling *long-standing weaknesses* in economic and credit fundamentals including the low tax take, infrastructure deficiencies and corruption, would further **support the case for an upgrade.**"

Fitch: Growth…

- Indonesia's economy grew 6.1% in 2010 after a mild slowdown to 4.6% in 2009, consolidating the five-year average at 5.7% pa, well ahead of the 'BB' and 'BBB' range medians (each 3.6% pa).
- Growth is being driven by domestic demand, supported by a pick-up in the investment rate to 32.5% of GDP in 2010, up from 24.9% in 2007.
- Indonesia's growth has not been accompanied by the emergence of potentially risky external imbalances – rising savings rates have largely matched rising investment, and the economy has run a modest current account surplus since 1998.
- Moreover, investment is well-diversified across the industrial and service sectors as well as the traditionally-important mining industry.
- Indonesia needs faster growth to narrow the income differential with rated peers; average income of USD3,000 in 2010 compares poorly with the 'BB' median of USD5,400 and the 'BBB' median of USD7,700.

Fitch: Debt & Deficit

- Indonesia's gross government debt to GDP ratio fell again to 26% of GDP by end-2010, well below the 'BB' median of 41% and the 'BBB' median of 37%.
- The budget deficit came in at 0.6% in 2010, extending a run of low deficits below 2% since 2002 that has contributed to the debt ratio reduction.

Fitch: BOP

- Official foreign reserves rose to a record USD96.2bn by end-2010, worth some seven months of imports and up 46% on the end-2009 figure.
- FDI inflows were also strong in 2010 at USD9.8bn (1.4% of GDP).
- A long run of current account surpluses has helped take Indonesia's net external debt down to the 'BB' median of 9% of GDP.
- Strengthening external liquidity supports the ratings, although portfolio capital inflows were a strong USD14bn in 2010, and any reversal in the event of a shift in investor sentiment could undo some of the improvement.

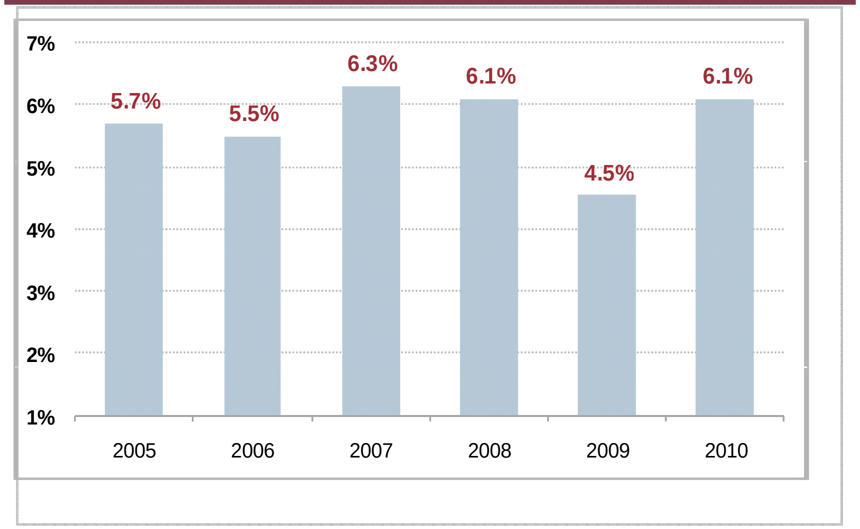
Improving International Perception:
Significant Raise in Perception Indices

Conducive business climate improvement to support optimism in FDI inflows

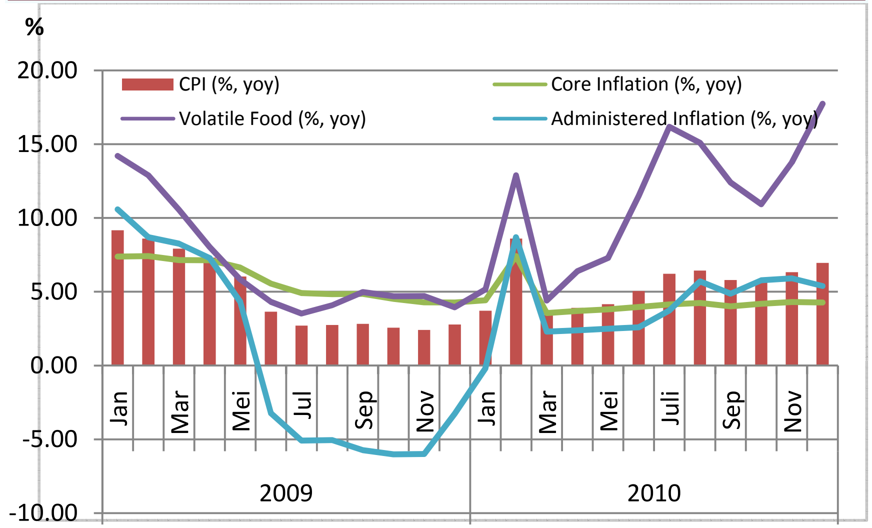
- **World Economic Forum – The Global Competitiveness Report 2010 – 2011 (September 15, 2010)** reported that Indonesia posts an impressive gain of 10 places, mainly driven by a healthier macroeconomic environment and improved education indictors. Indonesia considered to successfully maintain a relatively healthy macroeconomic environment throughout the crisis. While most other countries saw their budget deficits surge, Indonesia kept its deficit under control"
- **The IMD Competitive Center (May 19, 2010) reports a major improvement in Indonesia's global competitiveness, with Indonesia moving up from 42nd to 35nd place among a total of 57 major nations surveyed worldwide.** For Indonesia, the improvement in 2010 has been achieved through significant gains in economic performance, followed by government efficiency and infrastructure improvement.
- **OECD (April 2, 2010): upgraded Indonesia's Credit Risk Classification (CRC) from category 5 to 4.** This upgrade was a timely acknowledgement by the developed economies of the consistent economic improvement. This upgrade would significantly improve Indonesia's credit standing in front of the creditor countries especially the credit exports creditor countries which eventually would decrease the debt burden.
- **Currently, Indonesia is already part of the "Enhanced Engagement" program of the OECD** alongside other BRICs, with a view to possible membership

Macroeconomic Overview

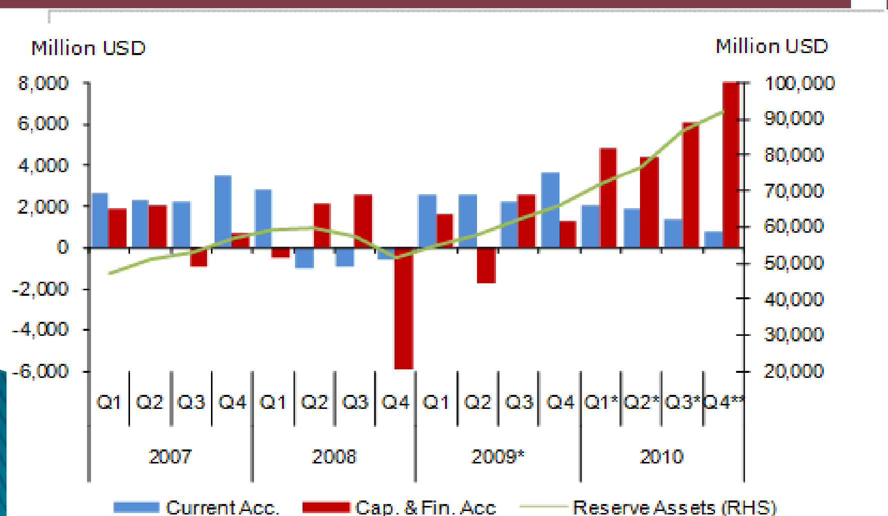
GDP Growth



Inflation



Balance of Payments



Foreign Exchange Reserves

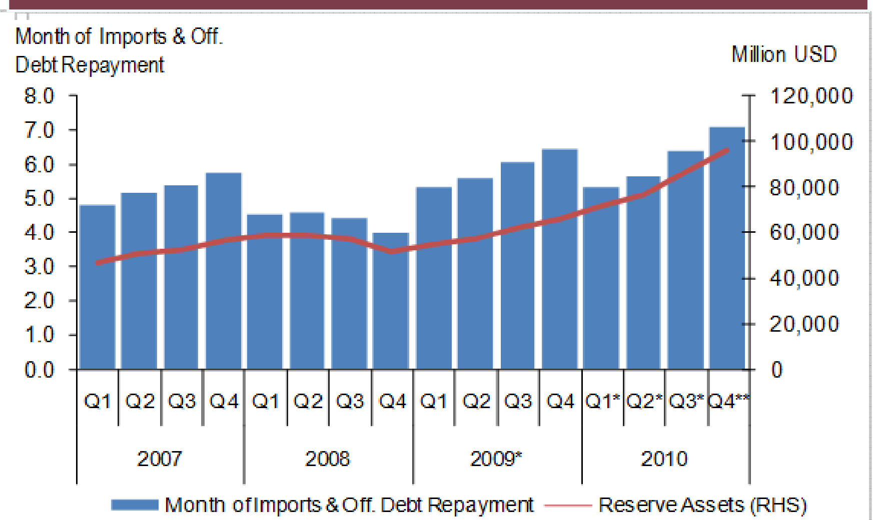
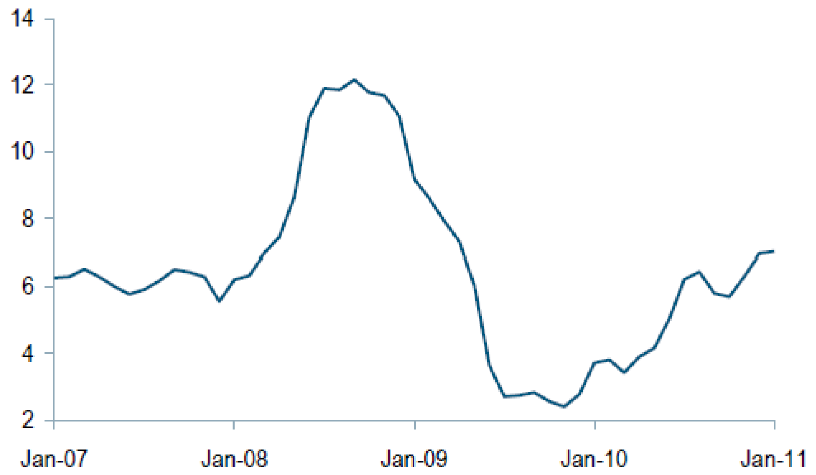


Chart 3: Headline inflation *(y/y %)*

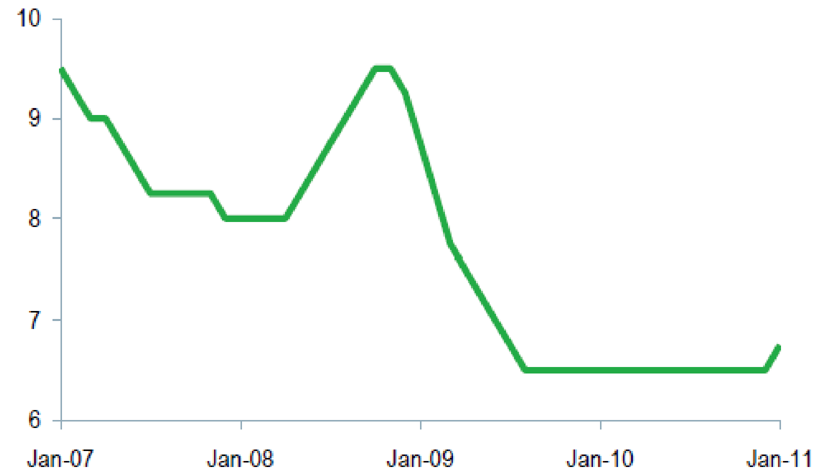
Headline inflation remains high on food inflation



Source: National Statistics Agency

Chart 4: BI rate *(%)*

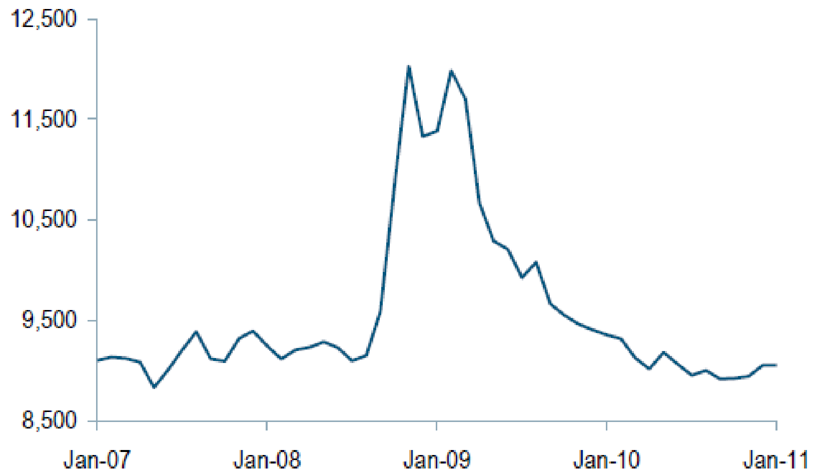
BI hikes policy rate, following other central banks in region



Source: Bank Indonesia

Chart 5: USD-IDR

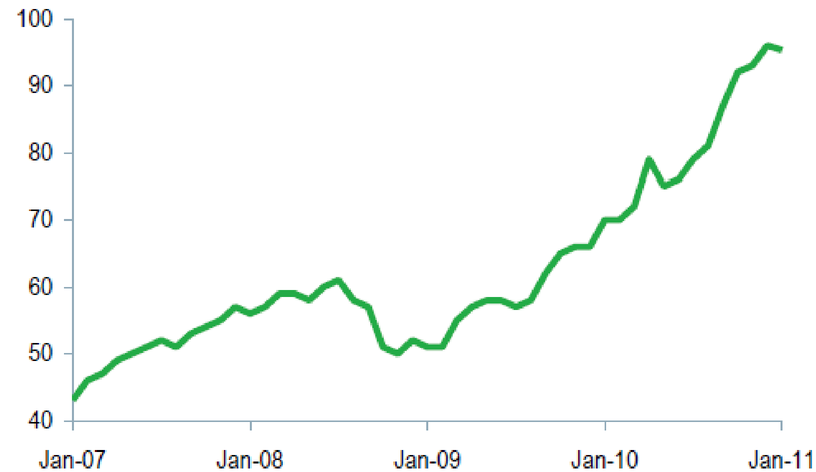
IDR reacts positively to BI rate hike



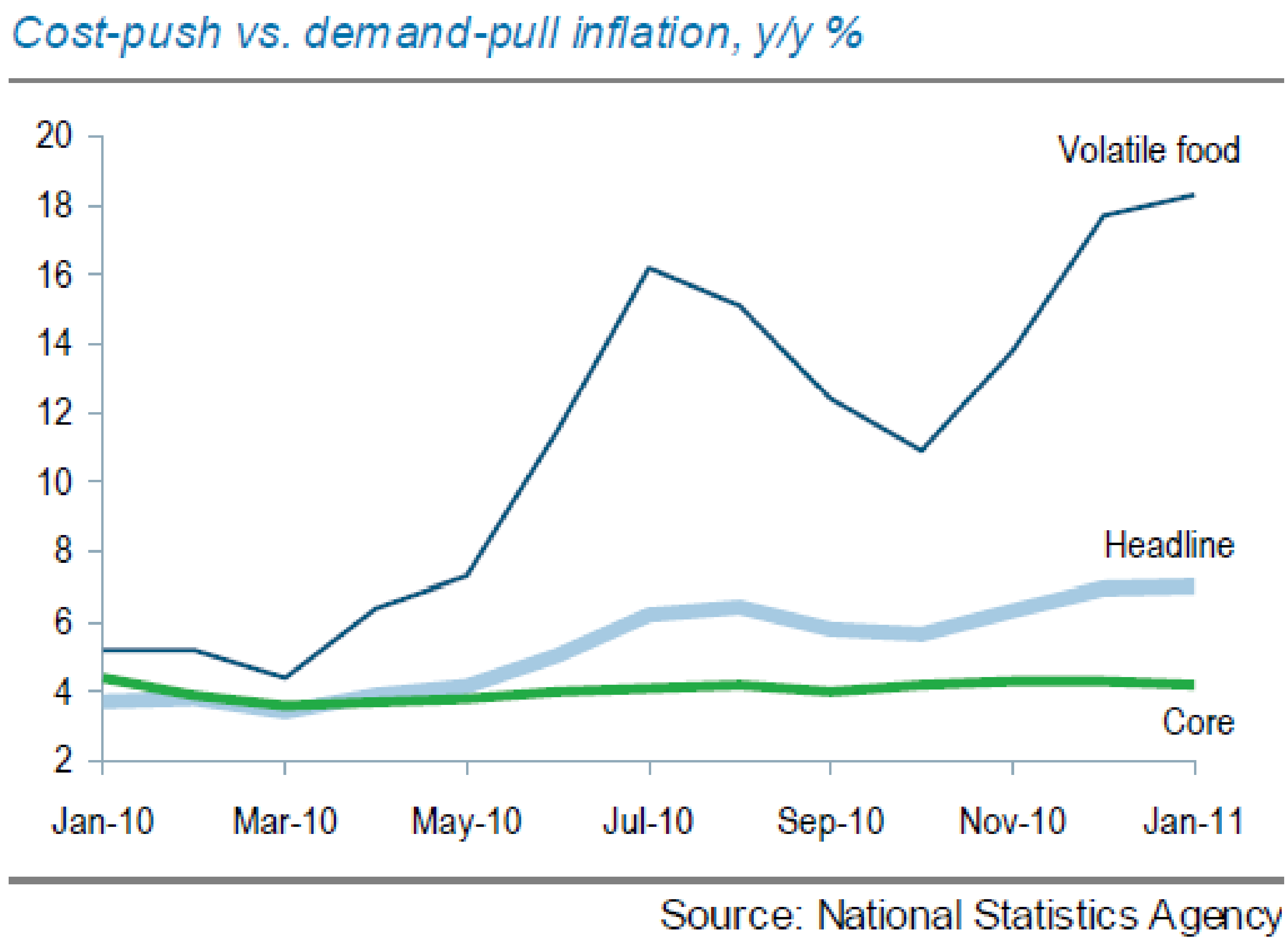
Source:Bloomberg

Chart 6: FX reserves, USD bn

FX reserves fall slightly due to market sell-offs in Jan-11



Source: Bank Indonesia


Cost-push vs. demand-pull inflation, y/y %
20
18
16
14
12
10
8
6
4
2
Volatile food
Headline
Core
Jan-10
Mar-10
May-10
Jul-10
Sep-10
Nov-10
Jan-11
Source: National Statistics Agency

Steps to tackle Food Inflation

The Government has been quick to acknowledge that food inflation must be tackled through administrative steps, and has introduced the policy package outlined below:

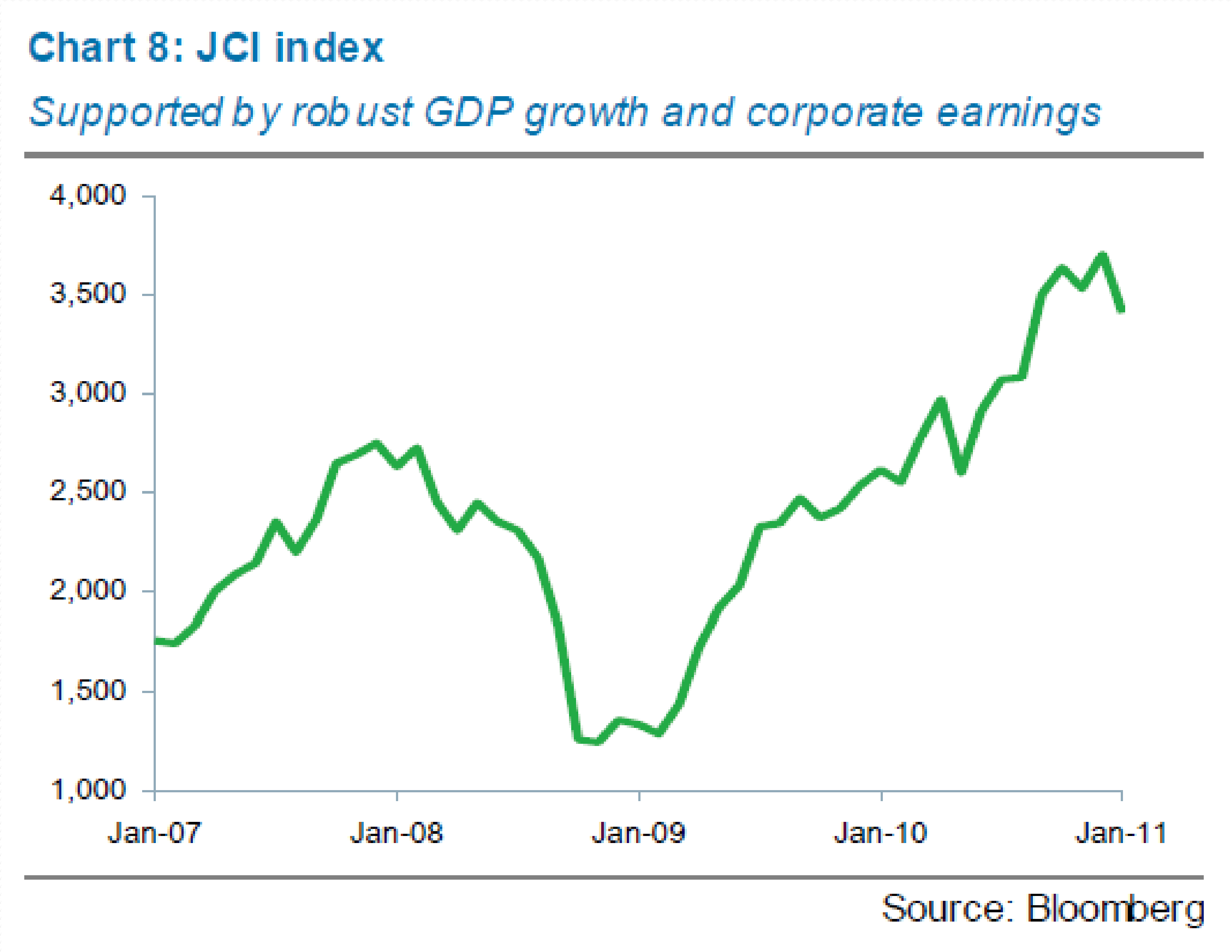
Table 1: Government policies to tackle food inflation

Zero import duty on 59 farm commodities for one year	Includes rice, soybeans and fertilisers, but excludes sugar
Increased trading flexibility for food logistics agency (BULOG)	BULOG can intervene independently in local rice market
Rice imports	To ensure that BULOG has at least 1.5mn tonnes of rice stock
Additional IDR 6trn (USD 670mn) in food subsidies	For subsidised rice, fertilisers and rice imports
Crackdown on rice hoarders	Enforcement by national police and regional governments

Source: Office of Co-ordinating Minister for Economic Affairs

Stock Index

chart



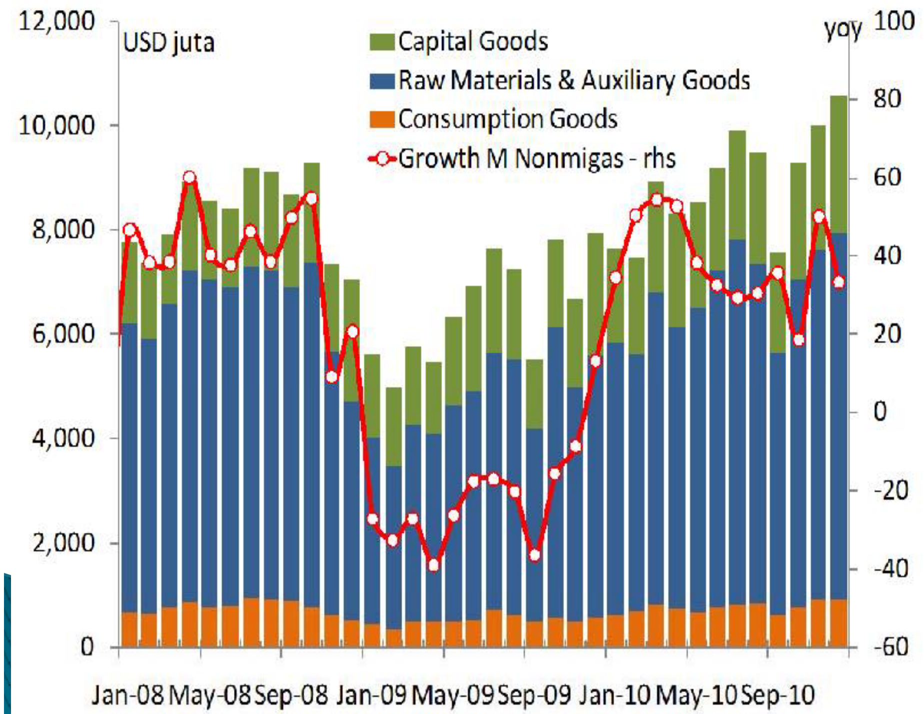
Balance of Payments

- Indonesia's balance of payments for Q4/2010 recorded a surplus of **US$11.3 billion**, above the US$7.0 billion surplus in Q3/2010.
- In Q4/2010, CA Surplus **US$1.2 billion** (0.7% of GDP)
- During the same period, the capital and financial account surplus mounted to **US$9.9 billion**.
- Surplus for the whole year was US$ 30.3 Billion.
- As a result, international reserves at end-Q4/2010 mounted to **US$96.2 billion**, equivalent to 7.0 months of imports and official external debt service payments.

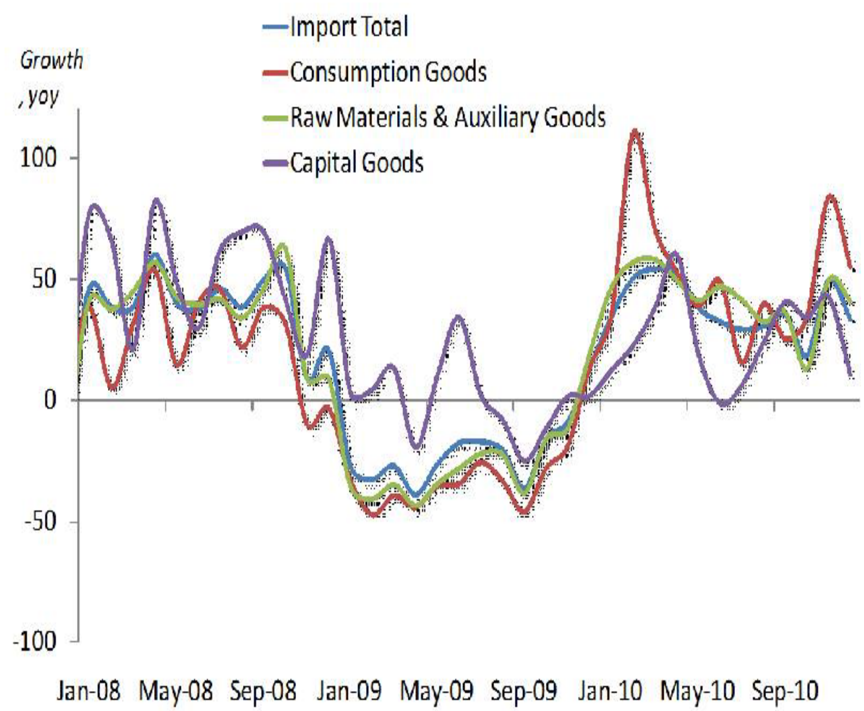
Non Oil & Gas Import

- Performance of Non Oil & Gas Import improved, however Import will tend to be accelerated further.
- Improved Import up to December 2010 supported by raw material/supporting import and capital goods import.

Non Oil & Gas Import



Growth of Non Oil & Gas Import (yoy)



Non Oil & Gas Export

Export 2010 was supported by increased volume and price.

10 Main Non O&G Export Commodity

Rincian	Jan-Des 2010				
	Nilai 2010	Pertumbuhan Nilai (%)		Volume (%)	Unit Price (%)
			Sumbangan Pertumbuhan (%)		
Coal	17,887	29.5	4.1	27.3	1.8
Electrical Appliances	12,967	25.2	2.6	17.9	6.2
Textile & Textile Products	11,561	21.6	2.1	12.0	8.6
Palm Oils	13,646	32.8	3.4	-2.9	36.8
Copper	9,836	25.3	2.0	4.7	19.7
Chemical Products	8,908	40.3	2.6	20.0	17.0
Machinery & Mechanic	7,233	12.3	0.8	16.7	-3.7
Rubber	7,347	131.3	4.2	20.6	91.8
Papers	5,529	30.1	1.3	8.7	19.7
Animal & Husb Products	2,729	12.2	0.3	15.4	-2.7
Total 10 komoditas utama	**97,644**	**31.2**	**23.4**		
Total Nonmigas	**129,797**	**31.1**			

Source: Bulletin Exim NM, DSM, Based On SITC

Foreign Direct Investment

- Total investment realization figure in Q4 (October–December) of 2010 is Rp. 58.9 trillion. Out of this number, Rp. 22 trillion is the realization of domestic investment (PMDN), and Rp. 36.9 trillion from foreign direct investment (PMA).

  Cumulatively for 2010, the total investment realization figure from both PMA and PMDN is Rp. 208.5 trillion, a 54.2% increase compared to the 2009 figure of Rp 135.2 trillion.

- Compared to the 2010 original target of Rp 160.1 trillion, this realization figure has exceeded the target by 30.2%.

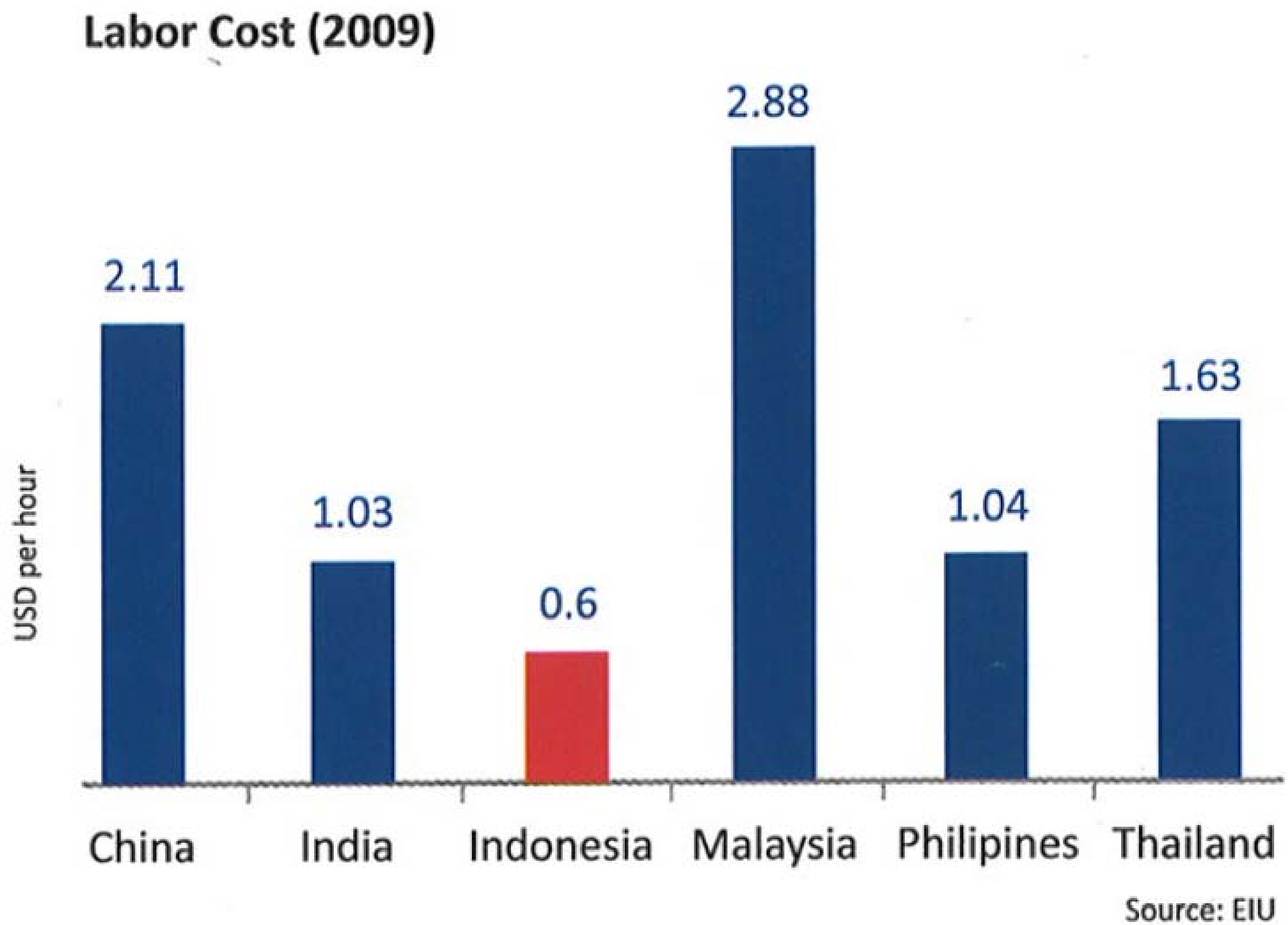
DOMESTIC INVESTMENT (PMDN) 2010

- Total Realization increased by 29%
- Investment Realization outside Java increased by 174%.
- Distribution: W Java Rp15.8T, E Java Rp8.1T, E Kal Rp7.9T, Banten Rp5.8T, Jakarta Rp4.5T.
- Top 5 Business Sector: Food Industry, Transportation and Telecommunication, Food Crops & Plantation, Electricity, Gas & Water Supply, Others.

FOREIGN DIRECT INVESTMENT (PMA) 2010

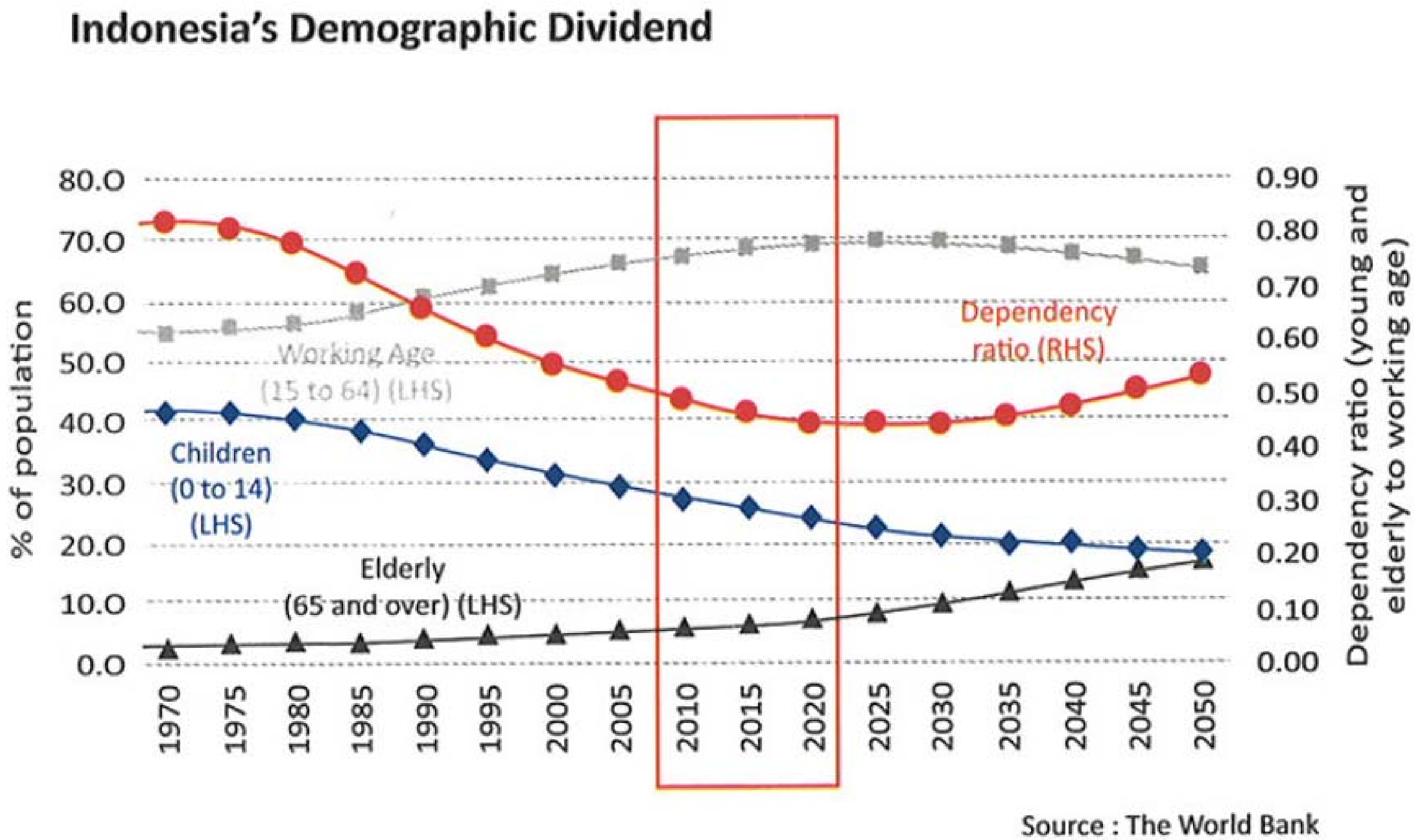
- Top 5 Business Sectors: Transportation, storage & Telecommunication ($5Bio), Mining ($2.2 Bio), Electricity, Gas & Water Supply ($1.4Bio), Real Estate, Indutrial Estate & Office Building ($1.1 Bio), Food Industry ($1 Bio).

LABOR COST



Labor cost is relatively low,
even as compared to investment magnets
China and India

DYNAMIC DEMOGRAPHIC BASE



•Of the 240 million people in Indonesia, over 50% of the population is under 29 years old

•Education spending accounts for 16% of total government expenditures, higher than any sector, and university graduates are trained in technical fields such as finance and economics (28%) or engineering and sciences (27.5%)

ABUNDANT IN NATURAL RESOURCES

Coal

- Indonesia is a major player in the global coal market
- The world's second largest thermal coal exporting country
- The world's 3rd largest exporter of steaming coal
- Production of almost 250 million tons

Natural Gas

- Around 107 trillion cubic feet of proven natural gas and is the single largest holder of proven natural gas reserve in the Asia Pacific region

Oil

- Over 4.3 billion barrels of proven oil reserves

Renewable energy

- Holds 40% of the world's geothermal resources, equivalent to 28.1 GW of power generation potential

Others

- Palm oil, cocoa, and other minerals

Source: Ministry of Energy and Mineral Resources (MEMR), BP statistical review of world energy 2009

Thank You

Q & A