COUNTRY **E**CONOMIC **R**EVIEW

I*NDONESIA*

April 2000

CURRENCY EQUIVALENTS
(as of 30 March 2000)

Currency Unit	–	Rupiah (Rp)	
Rp1.00		=	$0.000135
$1.00	=	Rp7, 400	

The exchange rate of the rupiah is determined under a freely floating system.

ABBREVIATIONS

ADB	-	Asian Development Bank
BI	-	Bank Indonesia
BPS	-	Badan Pusat Statistik (Central Bureau of Statistics)
CAR	-	capital adequacy ratio
CGI	-	Consultative Group on Indonesia
CPI	-	consumer price index
GDP	-	gross domestic product
IBRA	-	Indonesian Bank Restructuring Agency
IMF	-	International Monetary Fund
INDRA	-	Indonesian Debt Restructuring Agency
JITF	-	Jakarta Initiative Task Force
JSE	-	Jakarta Stock Exchange
NPL	-	nonperforming loan
SBI	-	Bank Indonesia Certificate

NOTE

In this report, "$" refers to US dollars.

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EXECUTIVE SUMMARY

Indonesia's severe economic contraction has bottomed out and clear signs of economic recovery have emerged. Preliminary estimates indicate that overall GDP grew by 0.23 percent in 1999. Although the fiscal stimulus was smaller than envisaged, it helped to stabilize the contraction. Private consumption then picked up and fueled the recovery. Investment contracted further in 1999, but the decline slowed markedly in the fourth quarter. Exports also declined further in 1999, but more slowly. On the output side, although the recovery was initially underpinned by a strong rebound in agriculture, it spread to virtually all non-primary sectors by the end of the year. Contraction of the services sector was marginal compared to the sharp decline in 1998, and reflected mainly continued decline of financial services.

Macroeconomic stability achieved towards the end of 1998 set the stage for recovery, and was greatly consolidated in 1999. Year on year inflation at the end of 1999 was only 1.9 percent compared to 78 percent at the end of 1998. Declining food prices, rupiah appreciation and the tight monetary stance together accounted for the sharp drop in inflation. High rupiah volatility experienced in 1998 was contained, and the rupiah traded within a narrow band of Rp6,800-Rp7,500/US$ in 1999. Low inflation and rupiah stability permitted the key one-month SBI interest rate to fall from over 35 percent in early 1999 to 12.5 percent at the end of the year. The consolidation of macroeconomic stability not only supported the economic recovery and reduced transient poverty, but also played a crucial part in improving market sentiment towards Indonesia.

The most severe macroeconomic impact of the crisis has been felt in the fiscal sector. Indonesia's public debt is currently estimated at 95 percent of GDP, up from 24 percent in 1997. Of the total public debt of $152 billion, almost 59 percent is domestic—bonds issued to recapitalize insolvent banks and liquidity injection to support failing banks when the crisis hit. Prior to the crisis only external debt was a source of budget financing. The implication of such a large public debt burden is that scarce public resources will have to be allocated to support current expenditures at the expense of public investment, thus undermining the country's growth potential for several years. Moreover, it will keep the macroeconomy more vulnerable to shocks compared to the pre-crisis period. The expansionary fiscal stance of recent years cannot continue indefinitely given the weakness of the Government’s accounts. As the recovery gathers pace, the expansionary stance must shift to fiscal consolidation and then to fiscal sustainability.

The external sector experienced its second consecutive current account surplus—3.5 percent of GDP. Both imports and exports fell in 1999. However, the surplus was again driven by import compression—imports fell 10.8 percent compared to a 7.4 percent decline in exports. The decline in imports however masks a sharp rise in consumer goods imports, and a much lower rise in intermediate imports. The decline in imports thus reflects declining capital goods imports due to declining investment demand. The failure of exports to respond to the massive exchange rate depreciation for a second straight year, reflects both lingering weakness of external demand and domestic factors such as corporate debt overhang of the manufacturing sector. Large net inflows of official foreign capital (external assistance) played a crucial role in stabilizing foreign reserves and the rupiah. Net private capital flows remained negative but were 33 percent lower in 1999 relative to 1998.

The quarterly trends in macroeconomic indicators clearly indicate that economic recovery is underway in Indonesia. However, the evidence also suggests that the recovery is still fragile due to important vulnerabilities. First aggregate demand is still weak, driven by private consumption. Investment and export contracted for a second consecutive year, although their decline slowed. Second, the massive build up in public debt has imposed a heavy burden on public finances. Servicing the debt burden and preventing any further fiscal deterioration will require extremely prudent public financial management. Third, while there has been progress in structural reform especially in the banking sector, corporate debt restructuring has been very slow. Without rapid progress in this area, investment demand will remain weak and export supply bottlenecks could constrain export growth even if external demand picks up.

Recent surveys indicate that transient poverty induced by the crisis peaked in February 1999 plunging an additional 17 million people below the poverty line in less than two years. Although transient poverty may have abated by the end of 1999, its adverse impacts will linger for many years. Survey results also show that the impacts are not uniform—the poorest in certain regions have suffered the worst deterioration in nutritional status. Moreover, the proportion of children most seriously at risk of malnutrition increased significantly. The serious impacts on education, health and nutrition will not be automatically reversed even if transient poverty drops to pre-crisis levels. Likewise, many whose savings and assets have been depleted will take a long time to recover from the crisis. Revised government estimates suggest that even with a return to pre-crisis poverty incidence, about 39 million people would be below the poverty line. In addition, many million people living just above the poverty line are also poor. Combating poverty in Indonesia must therefore be a foremost development priority, and the focus of public policy must accordingly shift to addressing problems of structural poverty in the post-crisis period.

On structural reforms, there has been substantial progress in bank restructuring in the past year. Major private banks and state banks have been recapitalized and restructured. However, some banks including Bank Mandiri, the largest (state-owned) bank is still experiencing a negative intermediation spread. Such "bleeding" of the capital base of state-owned banks in particular, could require further capital injections straining an already difficult fiscal situation. Resolving the status of the remaining state banks and other banks under IBRA control, and strengthening the legal framework and settling interbank claims transparently are key issues in the unfinished agenda of banking reforms. Another major financial sector issue is the need to accelerate capital market reforms, especially to develop a domestic bond market. This will permit more effective channeling of domestic savings to investment, and promote hedging instruments for foreign exchange risks.

Corporate debt restructuring is intertwined with the issue of financial sector reforms and holds the key to a rebound in investment, and to a lesser extent exports. Despite substantial improvement in the climate for resolution of such debt—appreciation of the exchange rate, low interest rates, strong rebound of the equity market, and reforms in the institutional mechanisms for corporate debt restructuring—the process has been painfully slow. A major impediment has been weak enforcement of the bankruptcy law, as reflected in a series of controversial court rulings. Unless credibility of the judicial process is restored quickly, the overhang of corporate debt could stall the recovery.

Indonesia must move the governance reform agenda forward decisively. The long history of cronyism and corruption has raised transactions costs, wasted scarce resources and, perhaps most importantly, eroded the confidence of the people in public institutions. Combating corruption, strengthening corporate governance, and effective decentralization are major priorities in governance reform. Credible progress and a firm sense of direction in governance reform are critically needed to restore public trust, investor confidence and continued support of Indonesia’s development partners. Without these, it would be difficult to sustain the recovery.

Looking ahead, the recovery should gather pace with continued consumption growth, a modest increase in investment and moderate non-primary export growth. Manufacturing growth will underpin recovery supported by a return to trend growth in agricultural production. Accordingly an overall GDP growth rate of around 4 percent in 2000, rising to 5 percent in 2001 is forecast. The budget will remain in deficit over the medium term, but decline steadily from 5 percent of GDP in 2000 to 3 percent in 2001 as private sector activity picks up and outlays on subsidies decline. Imports will increase in 2000 as domestic demand increases, lowering the current account surplus ratio to GDP to 2.2 percent in 2000 and 0.5 percent in 2001. This should, however, be offset by official financial flows and private capital inflows and the import coverage of reserves will remain at about 6 months.

Inflation is likely to exceed the government forecast of 5 percent in 2000, and reach 6 percent because of increases in wages and salaries, upward adjustments in fuel and electricity prices, and tariffs on rice and sugar. Inflation will decline to below 5 percent in 2001. With greater macroeconomic stability and adequate reserve cover, the exchange rate should remain stable at around Rp7,000-Rp7,500/US$ in 2000, but remain vulnerable to swings in market sentiment. However, with a strong increase in reserve growth and exports in 2001, it will drop below Rp7,000 per dollar. The interest rate is likely to drop from an average of 23 percent in 1999 to 11 percent in 2000. The public debt/GDP ratio is expected to decline somewhat with GDP growth, decline in interest rates, and larger asset sales by the Indonesian Bank Restructuring Agency (IBRA).

There remain, however, major downside risks at this stage of the economic recovery. Sound macroeconomic management must continue, public financial management must improve, reforms in the financial sector must remain on track, corporate debt restructuring needs to speed up and credible progress in governance reform is needed. The macroeconomic forecasts above are also predicated on the assumption that domestic political conditions of Indonesia will not deteriorate further and that the strong rebound of East Asian economies, including Japan’s, will continue.

The political transition in Indonesia was completed peacefully with the election of the President and Vice President in late 1999. The new government has expressed strong commitment to reform and development. The country faces many daunting challenges in sustaining the recovery and implementing its development agenda. The Government must quickly seize the historic window of opportunity provided by the popular mandate within the country and the strong support of the international community for Indonesia, to steer the economy back to the path of strong growth with prosperity for all Indonesians.

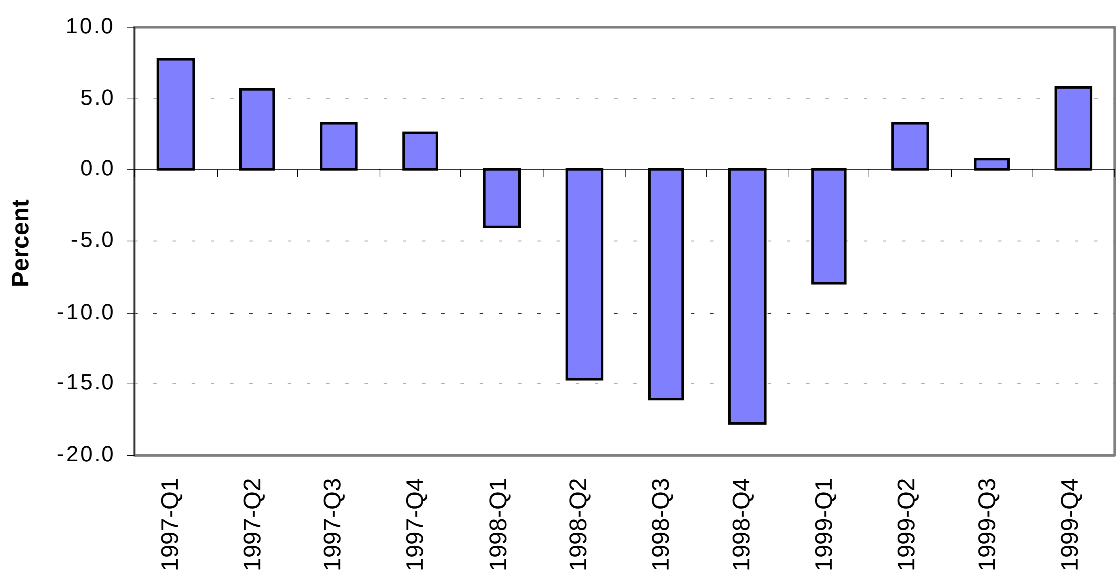
I. RECENT ECONOMIC DEVELOPMENTS[1]

A. Aggregate Output and Expenditure

1. After slowing to 4.7 percent in 1997 and contracting by a steep 13.2 percent in 1998, gross domestic product (GDP) stabilized in 1999. Year on year, the overall GDP contracted 7.9 percent in the first quarter, but then grew 3.3 percent in the second quarter, 0.7 percent in the third quarter and a strong 5.8 percent in the fourth quarter. In 1999 as a whole, overall GDP grew 0.23 percent, i.e., within the range forecast by the Asian Development Bank (ADB) in early 1999.[2] Although the recovery started in agriculture, most nonprimary sectors were growing by the third quarter of 1999. Signs of recovery are clearly visible in the quarterly data (Figure 1).

2. In its early stage, economic recovery was underpinned by a rebound in agriculture. However, a sharp contraction of 4.9 percent in the third quarter offset the early gains, resulting in an overall growth of merely 0.7 percent in agriculture in 1999. The performance of all agriculture subsectors, i.e., food, nonfood, crops, livestock, and fishery, was equally weak, while forestry output declined. The contraction in the third quarter was, however, seasonal in nature. Rice production was 49.8 million tons (t) in 1999—about 1 percent above its level in 1998—and is projected at 51 million t in 2000.

Figure 1: Quarterly Growth of Gross Domestic Product



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1 This review covers calendar year 1999. However, fiscal data are available only on a fiscal year basis. The data used are preliminary and were obtained from Government sources, i.e., Central Bureau of Statistics, Bank Indonesia, and Ministry of Finance. These sources were complemented by data from the World Bank and International Monetary Fund.

2 CER: INO: *Country Economic Review*, Indonesia, March 1999.

3. Domestic food security had already improved in the latter part of 1998 following the decision to liberalize rice imports. It improved further in 1999 as rice distribution channels were restored and the social safety nets were implemented more effectively. Rice imports fell sharply to 2.3 million t in 1999, down from 5.7 million t in 1998 as the need for food imports waned.[3] Domestic rice prices continued to fall in 1999, mainly due to a drop of over 20 percent in world prices. Appreciation of the rupiah and the vastly improved domestic supply also contributed to the decline in domestic rice prices. On the positive side, the sharp decline in rice prices kept rice affordable to the poor and low-income groups. The Government has, however, decided to impose a 25 percent import tariff on rice to protect rice producers in FY2000. While rice-producing farmers will benefit from such protection in the short term it will raise the price for consumers, including most farmers who are net consumers. The policy measure should be temporary, aimed at protecting rice producers against large short-term fluctuations in the world price and the exchange rate. Over time, the food security strategy should consider strengthening the market for private storage of food grain as a means to stabilize prices. An important role for public storage of food grain would, however, remain in Indonesia given, the structural problems of market integration in the vast archipelago, and the need to protect those in extreme poverty.

Table 1: Gross Domestic Product by Sectoral Origin
Constant 1993 Prices, 1994-1999
(percent)

Sector	1994	1995	1996	1997	1998	1999 Revised Estimates
Agriculture	0.6	4.4	3.1	1.0	0.8	0.7
Industry	11.2	10.4	10.7	5.2	-15.1	1.7
Mining and Quarrying	5.6	6.7	6.3	2.1	-3.1	-0.1
Manufacturing	12.4	10.9	11.6	5.3	-11.9	2.2
Oil and Natural Gas	4.9	-4.7	11.1	-2.0	1.6	6.1
Nonoil/Gas	13.5	13.1	11.7	6.1	-13.4	1.7
Electricity, Gas, and Water	12.5	15.9	13.6	12.4	1.9	7.2
Construction	14.9	12.9	12.8	7.4	-40.5	1.1
Services	7.1	7.6	6.8	5.6	-16.2	-1.5
Gross Domestic Product	7.5	8.2	7.8	4.7	-13.2	0.2
Nonoil/Gas	8.0	9.2	8.2	5.2	-14.3	0.4
Oil and Natural Gas	3.3	-1.4	4.3	-1.0	-1.0	-1.0

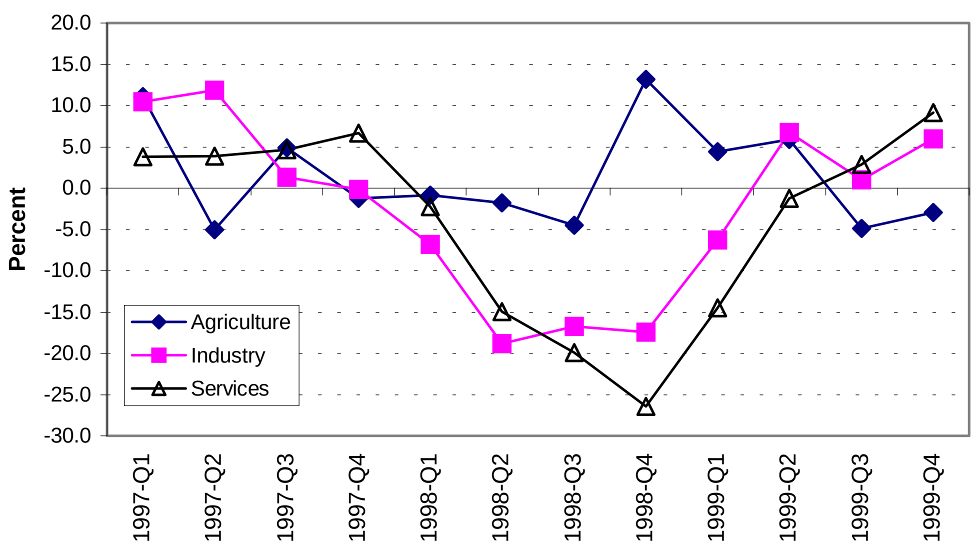
Source: Central Bureau of Statistics.

[3] The highest rice imports in Indonesia's history.

4. After contracting by 15.1 percent in 1998, the industry sector grew 1.7 percent in 1999 (Table 1). Although utilities showed strong growth (7.2 percent), mining stagnated. Manufacturing accounts for 60 percent of industrial GDP, but grew only 2.2 percent in 1999. The modest growth in manufacturing was due mainly to the 6.1 percent growth of the oil and gas subsector. Nonoil manufacturing, the driving force of high manufacturing growth prior to the crisis, grew only 1.7 percent. The annual growth rate, however, masks a strong rebound in this subsector in the fourth quarter. Construction, the subsector hardest hit by the crisis, began to recover in 1999, growing 1.1 percent. A major cause of the slow recovery of manufacturing and construction is the overhang of corporate debt and the weakness of the banking system. The banks are obliged to lend cautiously more because of the indebtedness of firms in these sectors than liquidity constraints. On the demand side, weak performance of the manufacturing sector reflects depressed export demand.

5. The services sector declined a further 1.5 percent in 1999 after contracting by over 14 percent in 1998. The contraction was due mainly to the continued decline of banking and financial services which contracted by 8.7 percent in 1999. The services sector is the mainstay of the urban poor, and its continued contraction could aggravate urban poverty. Quarterly growth of the three broad sectors of the economy (Figure 2) provides a more clear view of the economic recovery.

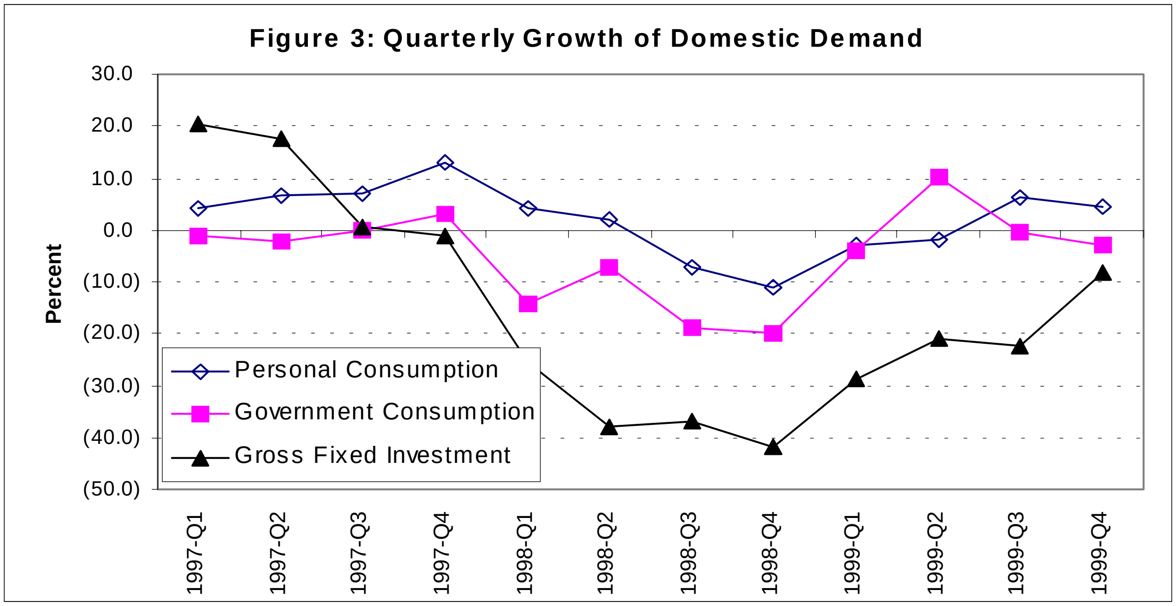
Figure 2: Quarterly Sectoral Growth of GDP



6. On the expenditure side, the investment rate[4] continued to slide in 1999. After collapsing to 19.1 percent of GDP in 1998 from its precrisis high of 31.8 percent, the investment rate dropped further to 11.6 percent in 1999. Following a 44.8 percent collapse in 1998, the downward trend in investment slowed but still fell 18 percent in 1999. At the present investment rate of 11.6 percent, Indonesia could achieve a maximum overall growth rate of

[4] Gross domestic investment divided by GDP.

only 2.9 percent.[5] A sharp rebound in investment is thus needed to sustain economic recovery and return to strong growth. The decline in investment reflects the collapse of the financial sector, the overhang of corporate debt, and the slow turnaround in foreign capital inflows. However, year on year, the contraction in investment decelerated over the four quarters of 1999 and it was particularly pronounced in the last quarter (Figure 3).



7. Total consumption grew 1.4 percent in 1999, supported by an increase in private consumption expenditures of 1.5 percent and public consumption of 0.7 percent. The marginal rise in public consumption reflects inadequate fiscal stimulus to the economy. The rise in private consumption, though meager compared with the brisk growth of 9 percent per annum in the three years preceding the crisis, reflects returning consumer confidence.

8. The trends in aggregate output and expenditure suggest that the severe recession of 1998 has bottomed out and that recovery has begun. Macroeconomic stability along with progress in structural reforms aided the recovery. However, the recovery is still fragile. On the output side, manufacturing activity remains weak, services need to rebound and agriculture must return to trend growth. On the aggregate demand side, a further drop in investment is a major concern although the deceleration in investment contraction visible in the quarterly data is a positive development.

[5] The estimate is based on an incremental capital-output ratio of 4 and an investment rate of 11.6 percent. It excludes any growth from increased capacity utilization. Indonesia could of course experience a higher growth due to utilization of the large existing capacity, as evidenced in the fourth quarter of 1999.

B. Fiscal Developments

9. Indonesia's fiscal situation reflects the worst effects of the crisis. The fiscal gap increased sharply in FY1998/99, obliging the country to turn to unprecedented levels of external assistance to finance the budget. Although the country appropriately adopted an expansionary fiscal stance, the large stimulus planned in 1998/99 could not be realized.[6] Fiscal policy, therefore, fell short of its objective of sparking a quick recovery during the crisis. However the fiscal stimulus, though smaller than planned, did serve to stabilize the contraction and supported the recovery.

10. The fiscal situation remained fragile in FY1999/2000. Domestic revenues increased, largely because of a sharp increase in world oil prices. Routine expenditures exceeded their projected levels by a substantial margin due to a sharp rise in petroleum subsidies. The rise in domestic revenues, however, permitted positive public savings to be realized. As in the previous year, the Government's fiscal stance in FY1999/2000 is expansionary. Although the projected fiscal deficit was 6.8 percent of GDP, provisional estimates indicate that the deficit will only be about 2 percent of GDP. Substantially higher oil revenues and lower development expenditures due to weak absorption of external project assistance and delay in bank restructuring caused the lower deficit. Thus, for two years in a row, fiscal policy will not have been adequately stimulative. Provisional estimates and budget forecasts for FY1999/2000 are summarized in Table 2.

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[6] The realized fiscal deficit in FY1998/99 was a mere 3.7 percent of GDP against a projected deficit of 8.5 percent of GDP.

Table 2: State Budget, FY1999/2000
(Rp billion)

Revenues	FY1999/2000 Budget	FY1999/2000 Provisional Actual	Expenditures	FY1999/2000 Budget	FY1999/2000 Provisional Actual
A. Domestic Revenues	**142,204**	**168,926**	**A. Routine Expenditures[a]**	**137,156**	**152,866**
1. Oil Revenues	20,965	45,010	1. Personnel Expenditures	33,569	33,502
Oil	12,443	28,819	Salaries/Pension	26,825	26,881
Natural Gas	8,522	16,191	Rice Allowances	2,087	1,899
			Food Allowances	2,107	2,289
2. Nonoil Revenues	121,239	123,916	Other Domestic Personnel	1,490	1,433
Income Tax	40,626	53,468	Overseas Personnel	1,060	1,000
Value Added Tax	34,597	30,430			
Import Duties	2,950	3,065	2. Materials Expenditures	11,039	10,712
Excises	10,160	10,302	Domestic	10,007	9,738
Export Tax	2,595	1,039	External	1,032	974
Land and Building Tax	3,247	3,344			
Other Taxes	565	468	3. Transfers to Regions	19,498	18,814
Nontax Receipts	26,499	21,802	Personnel Expenses	18,697	18,038
			Nonpersonnel Expenses	801	777
			4. Debt Service Payment	44,811	41,269
			Domestic	380	380
			External	44,431	40,888
			Principal	23,905	20,391
			Interest	20,526	20,498
			5. Others	28,239	48,570
			Oil Subsidies	9,986	25,776
			Others	18,253	22,793
B. Foreign Revenues	**77,400**	**43,718**	**B. Development Expenditures[a]**	**82,448**	**60,607**
1. Program loan	47,400	24,353	1. Rupiah Financing	52,448	41,242
			Transfer to Regions	16,129	14,745
			Financial Management by Central Government Institutions	15,618	16,843
			Bank Restructuring Cost	20,701	9,654
2. Project loan	30,000	19,365	2. Project Aid	30,000	19,365
C. Total	**219,604**	**212,645**	**C. Total**	**219,604**	**213,473**

[a] "Routine" and "Development" expenditures roughly correspond to current and capital expenditures, respectively.
Source: Ministry of Finance

11. Based on realization for the first three quarters of the fiscal year, total revenue is estimated to exceed its initial forecast by nearly 19 percent. This is mainly due to a doubling of oil revenues following a steep rise in the world price of oil from $10.50/barrel to $23/barrel. Higher income tax revenues reflect an increase in proceeds from the tax on interest income—interest rates were still high in the first half of FY1999/2000. Indonesia's tax effort, however, is low at less than 10 percent of GDP.[7] Realization of nontax revenue in FY1999/2000 fell short of its forecast by 18 percent. Nontax revenues include proceeds from privatization and dividends of state-owned enterprises. Revenues from privatization are critical to government financing and must be speeded up in FY2000.

[7] The tax effort measured by the total tax revenue-GDP ratio, is about 20 percent for Thailand and 35 percent for Malaysia.

12. On the expenditure side, the provisional budget estimates for FY1999/2000 show that the initial routine expenditure forecast will be exceeded by 11.4 percent. The share of subsidies in routine expenditure increased sharply from the budget forecast of 20.6 percent to 31.8 percent. The large overshoot was due to more than doubling of petroleum subsidies. Increases in world oil prices are a double-edged sword for Indonesia. While rising world oil prices raise revenues, subsidies to the domestic petroleum industry also increase. For a given increase in the world oil price, over half the incremental oil revenue is lost to the concomitant rise in oil subsidies. Other subsidies mainly include transfers for food and electricity.

13. Total debt service in FY1999/2000 was estimated at Rp41.3 trillion or 27 percent of routine outlays. Domestic debt service was negligible in FY1999/2000 since interest payments on bank recapitalization bonds did not fall due. Subsidies and debt service together accounted for about 60 percent of routine expenditures and over half of Indonesia's total revenue. These expenditures reveal the heavy fiscal burden imposed by the crisis. Although expenditures on subsidies will decline over the medium term, debt service obligations will increase. Development expenditures fell short of the target by more than 25 percent. Although the absorption of program assistance reached about 80 percent of the target, it reached only about 65 percent of the target for project assistance. It improved significantly compared with FY1998/99, but needs to improve much more.

14. The expansionary fiscal stance in the wake of the crisis was possible largely because Indonesia had managed its budget prudently in the years leading up to the crisis. The sharp increase in public debt, a narrow revenue base and growing constraints on the availability of external financing—all point to the need to achieve fiscal consolidation as the recovery gathers pace and to fiscal sustainability over the medium term. Achieving this will require more effective and transparent use of resources, greater commitment to domestic resource mobilization, accelerating sale of Indonesian Bank Restructuring Agency (IBRA) assets and privatization, and reduced borrowing.

15. The FY2000 budget was presented to Parliament on 20 January 2000.[8] The macroeconomic framework of the budget assumes a GDP growth of 3.8 percent, inflation rate of 4.8 percent, average exchange rate of Rp7,000/$1, and an average oil price of $20/barrel. The budget deficit in FY2000 is forecast at Rp44.1 trillion (about $6.5 billion), or about 5 percent of GDP. This is 1 percent above the provisionally estimated realized fiscal deficit in FY1999/2000 (Table 3).

[8] The FY2000 budget covers the nine-month period, April-December 2000. See Table 3 footnote.

Table 3: State Budget for FY2000[a]
(Rp billion)

	Budget		Budget
Domestic Revenues and Grants	**152,897**	**Government Expenditures**	**197,030**
A. Domestic Revenues	**152,897**	**A. Routine Expenditures[b]**	**155,425**
1. Tax revenues	101,437	1. Personnel expenditures	30,682
a. Domestic revenues	95,538		
i. Income tax	54,225	2. Materials expenditures	9,441
-Nonoil and non-gas	44,189		
-Oil and gas	10,036	3. Regional routine expenditures	18,114
ii. Value added tax	27,002	4. Interest payments	54,623
iii. Land and building tax	2,901	a. Domestic	37,998
iv. Excises	10,272	b. External	16,625
v. Other taxes	1,139		
b. International trade taxes	5,899	5. Subsidies	30,828
i. Import duties	4,976	a. Fuel subsidies	22,462
ii. Export taxes/duties	923	b. Nonfuel subsidies	8,366
2. Nontax state receipts	51,460	6. Other routine expenditures	11,737
a. Resource royalties	40,082		
i. Oil and gas	**33,230**	**B. Development Expenditures**	**41,606**
ii. Other natural resources	6,853	1. Rupiah Financing	25,576
b. Dividends from state firms	5,281	a. Budget managed by regional gov't	15,409
c. Other nontax receipts	6,096	b. Budget managed by central gov't.	10,167
B. Grants	0	2. Project financing	16,030
		C. Surplus/ Deficit	-44,134
		D. Financing, Net (D1+D2 = D = C)	**44,134**
		1. Domestic Funding	25,400
		a. Sales of government stakes in commercial banks	0
		b. Nonbanking	25,400
		-Privatization	6,500
		-Assets recovery by IBRA	18,900
		2. Foreign Financing	18,734
		a. Loans drawing	27,330
		-Program loans	11,300
		-Project loans	16,030
		b. Loan amortization	-8,596

IBRA = Indonesian Bank Restructuring Agency.

[a] The 2000 budget, called the transitional budget, covers the period 1 April to 31 December 2000. The Government is aligning the budget to the calendar year, instead of the traditional 1 April to 31 March fiscal year. The budget assumes 3.8 percent GDP growth for FY 2000, 4.8 percent inflation rate, an average oil price of $20 per barrel, and average exchange rate of Rp7,000/$. The budget presented in the table reflects revisions made by Parliament.

16. The format of the FY2000 budget was changed to conform to international standards and improve the transparency of fiscal accounts. The budget forecasts negative public savings of about Rp2.5 trillion. Since the crisis started, this is the second fiscal year which forecasts negative public savings, i.e., routine expenditures exceed domestic revenues. Thus, part of total fiscal resources (equivalent to about $400 million) will be diverted away from development to current expenditures. About 70 percent of domestic revenues will accrue from taxes. Although the Rp101 trillion tax revenue target appears somewhat ambitious, it is likely to be met because of high income tax revenues from interest payments on government bonds. Routine expenditures reflect a 20 percent increase in government wages and salaries. The

decline in subsidies reflects projected increases in electricity and fuel prices of 35 percent and 20 percent, respectively.

17. The most significant aspect of the FY2000 budget is a massive increase in domestic debt service payments. At Rp38 trillion, the amount is more than twice the external debt service payments. Total public debt service payments comprise 35 percent of routine expenditures. Together, subsidies and debt service expenditures comprise about 55 percent of routine expenditures. Total debt service payments will absorb 54 percent of tax revenues. Of this, domestic debt service alone will absorb 37 percent. These estimates show the lingering fiscal impacts of the crisis.

18. The FY2000 budget projects a net financing gap of Rp44 trillion to be met approximately equally by domestic and external financing. The Government will have to keep the privatization program on track and substantially accelerate IBRA's asset recoveries to meet the domestic financing target. The Consultative Group on Indonesia Meeting held in Jakarta recently culminated in a commitment of $4.4 billion-4.7 billion in external financing to support the FY2000 budget. ADB indicated a planned disbursement of $1.5 billion in calendar year 2000, $960 million of which would be quick-disbursing assistance.

C. Monetary Developments

1. Monetary Aggregates

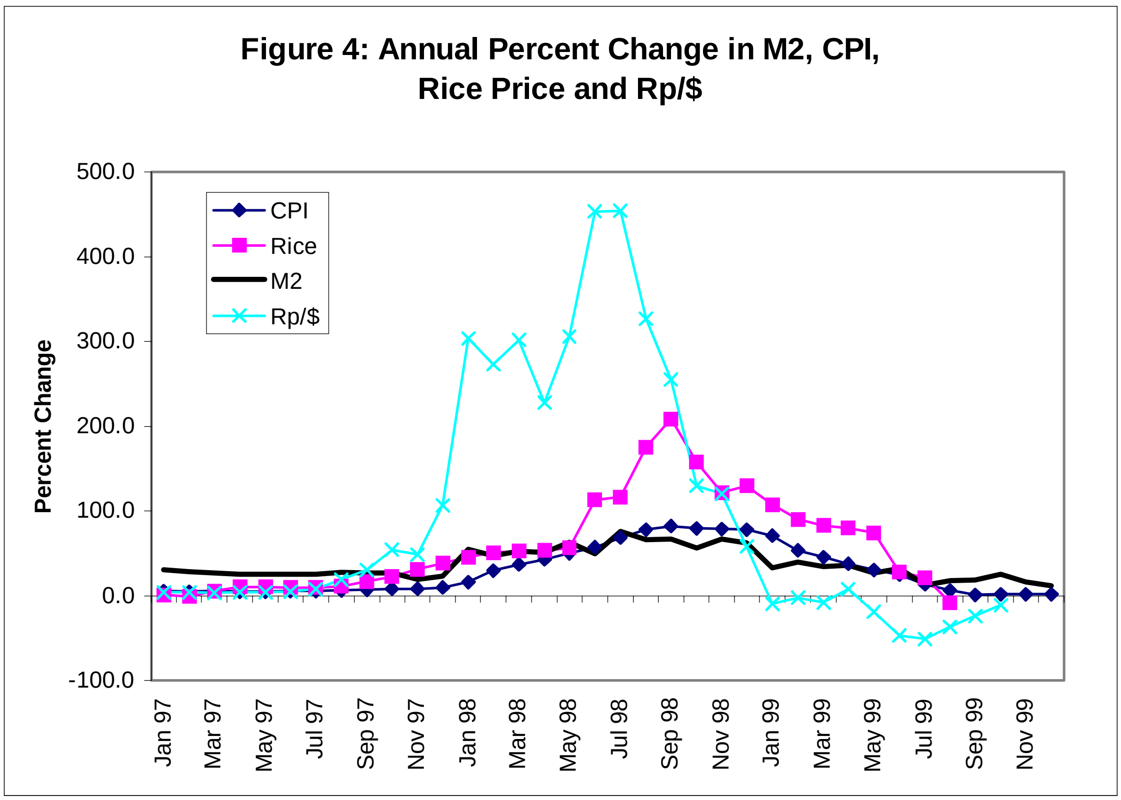
19. Monetary policy remained tight to keep inflation in check and stabilize the exchange rate. As part of the monetary program in 1999, quarterly targets were set for net domestic assets, base money, and net international reserves. All monetary aggregates in 1999 met their targets, except in February-March and September 1999 when base money overshot its target due to delays in the bank recapitalization program. Net international reserves were in the range of $15 billion-$16 billion, well above the indicative target of $11 billion-15 billion in 1999. The demand for currency moved within a narrow range compared with the wide fluctuations experienced in 1998, signaling consolidation of the rupiah's strength. This is further substantiated by steadily growing rupiah deposits in both nominal and real terms in 1999. The tight overall monetary stance helped to consolidate macroeconomic stability in 1999, however, some easing did take place in the latter part of the year to support economic recovery.

20. In sharp contrast to the 62 percent surge in the previous year, liquidity increased only 11.9 percent (year on year) at end-1999. The growth of liquidity in 1999 was caused mainly by the growth of credit to the central Government. The sharp rise in net claims on the central Government was the consequence of full conversion of Bank Indonesia’s (BI) liquidity support to troubled banks into the Government’s liabilities in February 1999, and the latter's bond issues to recapitalize eligible banks. In contrast, private sector credit declined to almost 50 percent of its level in the beginning of 1999. This reflects a crowding-out effect.

21. BI continued its open market operations to absorb liquidity so as to sterilize the effects of rising external reserves. Apart from the weekly auctions of one-month BI certificates (SBIs), BI also conducted monthly auctions of three-month SBIs and carried out daily interventions in the interbank market for shorter maturities. The sterilization operations also included limited access to automatic liquidity to encourage the lengthening of SBI tenor.

2. Inflation

22. The most remarkable development in macroeconomic indicators in 1999 was, perhaps, the taming of inflation. From 77.6 percent at end 1998, year-on-year inflation dropped to a mere 1.9 percent at end-1999. The consumer price index (CPI) declined successively for seven months from March to September, stoking fears of a deflationary spiral, but then increased through December. Declining food prices and appreciation of the rupiah contributed most to the deceleration of inflation. Tight monetary policy also helped to keep inflation in check. Figure 4 shows the impact of these factors on the CPI. The rise in inflation in the last quarter of 1999 was due to seasonal factors—yearend festivities that included Ramadhan.[9] Low inflation in 1999 was in sharp contrast to the Government's year-end forecast of 25 percent earlier in the year.



M2 = money supply; CPI = consumer price index.

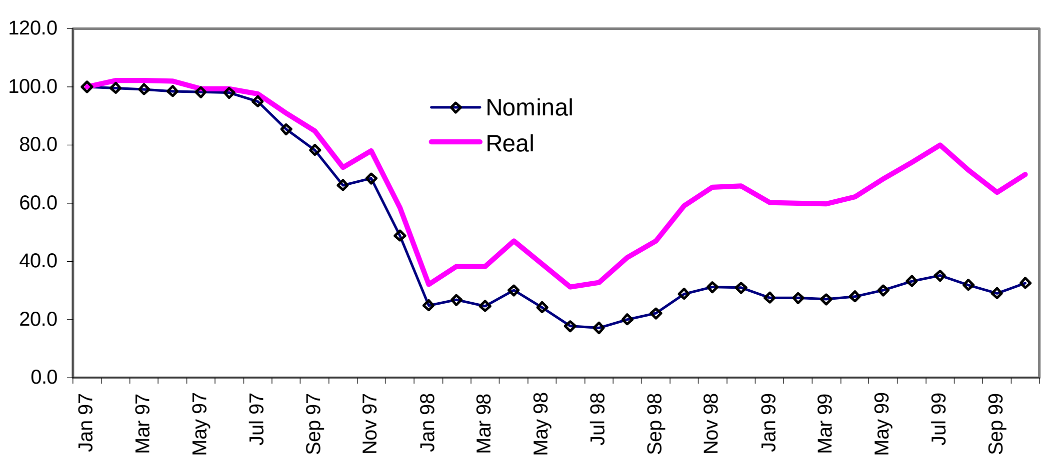
3. Exchange Rate

23. The rupiah was far less volatile in 1999, ranging from Rp9,500-Rp6,700 to $1 in contrast with Rp7,500-Rp17,000 to $1 in 1998 (Figure 5). Fluctuations in the rupiah in 1999 continued to reflect market anxiety over the pace of structural reforms and political developments. Landmark political developments—peaceful parliamentary polls and election of

[9] Muslim religious event.

the President and Vice President of the country strengthened market confidence. Such confidence along with macroeconomic stability—low inflation and higher foreign reserves contributed to the strength of the rupiah in 1999. Compared with that in 1998, the exchange rate ended the year 1999 at Rp7,700/$1, which is closer to the market perception of the equilibrium exchange rate of about Rp7,000/$1 at present. The real exchange rate appreciated by about 15 percent in 1999, but still remained nearly 30 percent below its precrisis level. This provides Indonesia's exports a significant competitive advantage over its principal regional competitors, Malaysia, Thailand, and Philippines.

Figure 5: Nominal and Real Effective Exchange Rate Indices[a]



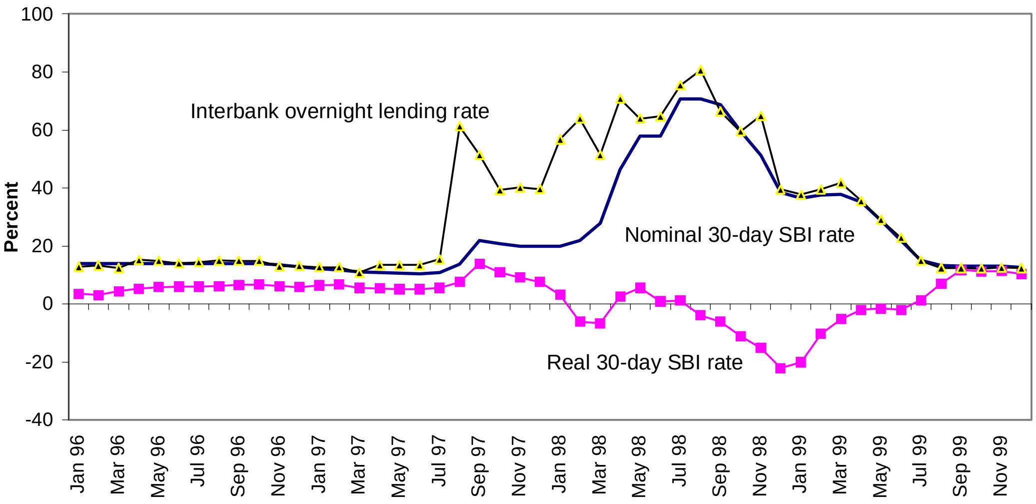
[a] The nominal exchange rate index refers to the monthly average $/Rp index, at January 1997=100, using data from International Monetary Fund-International Financial Statistics. The real effective exchange rate index refers to the monthly average inflation-adjusted $/Rp index, at January 1997=100, using data from J.P. Morgan & Co., Inc. A decline in the indices represents a depreciation.

4. Interest Rates

24. The decline in interest rates in 1999 in sharp contrast to the previous year, was a highly positive development. With confidence returning in the rupiah and steep deceleration in inflation, interest rates also declined—sluggishly in the first five months of 1999, and then dramatically (Figure 6). The one-month SBI interest rate was above 35 percent in early 1999, but declined to 12.5 percent at year-end. The interbank money market rate also declined in tandem. The bank lending rates also declined, but not as much. The high-posted lending rates are, however, ineffective since borrowing firms cannot afford high rates. Consequently, banks discounted their lending rates. However, the average effective lending rate was higher than the average deposit rate for the banking sector as a whole. Thus in contrast to the previous year, the bank intermediation spread turned positive on average in 1999. Weaker banks, however, continued to experience negative intermediation spreads because their effective lending rates

remained below deposit rates. The effective interest rate structure reflects the dysfunctional state of the banking sector at present.

Figure 6: Nominal and Real Interest Rates, 1996-1999[a]



[a] The real interest rate was computed as [(1+r)/(1+p)-1] x 100 where r = nominal one-month Bank Indonesia Certificate (SBI) rate and p = inflation rate based on the consumer price index.
Source of basic data: Nabk Indonesia

25. The term structure of interest rates also changed significantly-- short-term deposit rates fell faster than longer-term rates. Thus, the yield curve of Indonesian maturities also turned positive in 1999. This is expected to shift allocation of funds from short- to long-term deposits, and strengthen the financial position of banks. Notwithstanding these favorable developments in the banking sector, banks are taking a very cautious approach to new lending to strengthen their capital adequacy ratios (CARs).

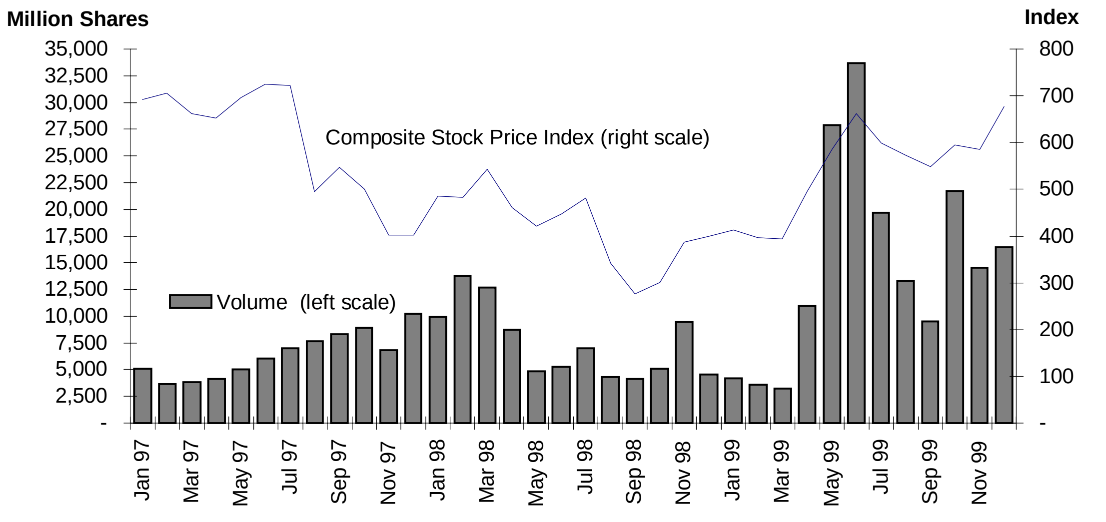
26. In sharp contrast to 1998, real interest rate also turned positive in 1999 following the much faster deceleration in inflation relative to nominal interest rates. With year on year inflation at about 2 percent and nominal interest rates at 12.5 percent, real interest rate was about 10.5 percent at end-1999. Although there is some more room for nominal interest rates to decline, it is unlikely to be large. The risk premium associated with Indonesian securities (reflecting foreign exchange and country risk) was 7-10 percent prior to the crisis, and is presently at this level. It is unlikely that the risk premium will fall significantly below this level in the near term. Moreover, banks still need to provision for bad debt. The nominal interest rate is thus likely to reach a floor around 10 percent, in the forseeable future.

5. Capital Market

27. The Jakarta Stock Market index (JSE) had started recovering by the end of 1998 following its collapse earlier that year (Figure 7). The JSE was volatile in the first half of 1999 showing sensitivity to political developments in particular. The peaceful parliamentary polls

boosted the index nearly 60 percent in mid-June. The equity market gained not only from the landmark political changes but also from increased macroeconomic stability—lower inflation, stable rupiah, and lower interest rates. Market capitalization rebounded strongly to reach $58 billion at end-1999 from $22 billion early in the year. At its lowest point during the crisis, market capitalization had fallen to only $11 billion in September 1998. The 160 percent rise in market capitalization in 1999 reflects a turnaround in market sentiment toward Indonesia. However, market capitalization is still well below the precrisis level of $90 billion. The equity market was largely driven by foreign participation in 1999. Strengthening of the equity market has improved the financial health of the corporate sector and will positively influence corporate debt restructuring. It has also improved the outlook for the Government's privatization program and IBRA's asset recovery effort.

Figure 7: Transactions in the Jakarta Stock Exchange



Source: Bank Indonesia.

D. External Sector

1. Balance of Payments

28. The current account surplus increased to $4.9 billion or about 3.5 percent of GDP in 1999 (Table 4). This follows a surplus of $4.1 billion or 4.1 percent of GDP in 1998. The current account surplus, however, continued to be driven by declining imports rather than buoyant exports. Net official transfers from abroad[10] in 1999, although 35 percent below the previous year's level, boosted foreign reserves and played a critical role in stabilizing the external account. The decline in the level of external assistance is consistent with declining need for such assistance as the recovery picks up. Net foreign private capital inflow remained substantially negative in 1999. However, the magnitude of the outflow declined by about 33 percent.

[10] Net external assistance

Table 4: Balance of Payments, 1994-1999
($ million)

Transaction	1994	1995	1996	1997	1998	1999[a]
A. Current Account	-2,960	-6,760	-7,801	-5,001	4,097	4,904
1. Merchandise	7,901	6,533	5,948	10,074	18,429	18,174
Exports, FOB	40,223	47,454	50,188	56,297	50,371	46,655
Imports, FOB	32,322	40,921	44,240	46,223	31,942	28,481
2. Services, Net	-10,861	-13,293	-13,749	-15,075	-14,332	-13,270
B. Capital Account, Excluding Re:	4,008	10,589	10,989	2,542	-3,875	-2,828
1. Official Transfer & Capital, Ne	307	336	-522	2,880	9,971	6,453
2. Private Capital, Net	3,701	10,253	11,511	-338	-13,846	-9,280
C. Overall Balance (A+B)	1,048	3,829	3,188	-2,459	222	2,076
D. Net Errors and Omissions	-242	-2,313	1,264	-1,651	2,122	1,821
E. Monetary Movements[b]	-806	-1,516	-4,452	4,110	-2,344	-3,898
Memo Items:						
Current Account (percent of GDF	-1.7	-3.3	-3.4	-2.3	4.1	3.5
External Debt ($ billion)[c]	83.3	101.3	106.5	113.1	138.0	149.8

FOB = freight-on-board; GDP = gross domestic product.

[a] Actual data for the first three quarters and Asian Development Bank estimates for fourth quarter of 1999.

[b] A negative change in net foreign assets indicates accumulation of assets. Since 1998, monetary movement is based on gross foreign assets replacing official reserves.

[c] Data for fiscal year ending March.

Source: Bank Indonesia, Ministry of Finance, World Bank and staff estimates..

2. Imports

29. The severe import compression experienced in 1998 eased in 1999. The decline in total imports slowed sharply to about 11 percent 1999 from 31 percent in 1998. The decline was caused by continued strong decline of 35 percent in capital goods imports in 1999, reflecting weak investment demand. However, the decline in total imports masks a strong rebound in consumer goods imports. Intermediate goods imports, critical in sustaining the recovery, also increased by 5 percent.

3. Exports

30. Rising world prices boosted oil exports by over 16 percent in 1999. However, nonoil exports, which fueled Indonesia's remarkable export-led growth in the precrisis period contracted by 11.5 percent, causing total exports to decline by 7.4 percent in 1999. The weak performance of manufactured exports remains a cause for concern, especially in view of the large depreciation of the real exchange rate. In real terms, the rupiah has depreciated over 30 percent since the crisis started. As stated earlier, this gives Indonesia a significant competitive advantage over countries such as People's Republic of China,[11] Philippines, and Thailand.

[11] PED staff study, Prospects for Indonesia's Exports, December 1999.

Although the weak manufactured exports revenue masks modest growth in export volume, revenues also need a sharp rebound to sustain the recovery.

31. Indonesia's manufactured exports are constrained by a combination of factors. The collapse of the banking system, the overhang of corporate debt, and the sharp rise in the cost of imported inputs have constrained the supply response. The problems of credit access appear to be related more to the corporate debt overhang of borrowers than to the liquidity of banks. On the external side, the demand for Indonesia's exports, especially electronics, remained weak. However, a rebound in manufactured goods exports is still possible in the near term especially with progress in debt restructuring, because of Indonesia's competitive advantage and continuing recovery in the region.

4. External Debt

32. The total external debt at the end of FY1999/2000 is forecast at $145 billion, of which private sector debt is about $64 billion[12] and public debt is $81 billion.[13] Nearly 80 percent of the external debt—the bulk of it private debt—is of short-term maturity. This underscores the need for accelerating private debt restructuring, more prudent external borrowing by the private sector and more prudent lending by foreign banks in the future. Strong recovery in export revenues is also needed to keep the external debt service burden stable.

33. Resolution of private interbank debt under the Frankfurt Agreement of June 1998 made more progress in 1999. Foreign creditor banks agreed to a second exchange offer under the London Club. Under the agreement, Indonesian banks will exchange their existing obligations for new loans guaranteed by BI. A settlement of $3.02 billion in bank obligations falling due prior to 1 April 1999 was transformed into new loans guaranteed by BI, and with tranche repayments of 1-4 years. The London Club also extended to 31 December 1999 the maturity of the interbank debt amounting to $3.3 billion falling due by 1 April 1999. This excludes repayments under the first exchange offer agreed upon in March 1998. The agreement required eligible debts to be reconciled before they can be transformed into new loans. By end-1999, the entire $3.3 billion had been reconciled and exchanged.

34. Resolution of private corporate debt continued under the Jakarta Initiative. Although macroeconomic stability, recapitalization of the banking sector, strengthening of the equity market and an upturn in domestic demand improved the outlook for corporate debt restructuring, its pace remained very slow in 1999.

35. The Paris Club creditor nations agreed to reschedule Indonesia’s sovereign debt amounting to $4.2 million in 1998. However, a Paris Club meeting could not be held in 1999. The political transition and resolution of complex issues concerning international contracts of PLN (the state-owned electricity monopoly) with independent power producing companies delayed the Government’s preparation for the meeting. Rescheduling by Paris Club donors is expected to provide about $2.2 billion out of an estimated external financing gap of $4.4-$4.7 billion in the FY2000 budget.

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[12] About 91 percent of the private sector debt is held by corporations.

[13] Of the public external debt, $71 billion is held by the Government and state enterprises, state banks, and public corporations. Other liabilities of the Government account for the rest of the external public debt.

36. The external debt service ratio, after rescheduling, is estimated at 35 percent in FY1999/2000, down from 39 percent in FY1998/99. The debt service ratio is forecast to decline to 30 percent over the medium term, i.e., lower than 32.6 percent in FY1995/96. The total external debt/GDP ratio stood at about 91 percent at the end of 1999.[14] It soared to 93 percent in mid-1998 from 56 percent in mid-1997. The per capita external debt was estimated at about $685 at end-1999. The steep rise of the external debt burden relative to precrisis years will constrain investment and import capacity, limiting Indonesia's future economic growth prospects.

37. The proximate cause of the crisis—large build up of short term private debt, relative to foreign exchange reserve cover—has not been addressed adequately, despite major structural reforms so far. The reserve cover has of course increased and the risk of a speculative attack on the rupiah at present is low. However, there may be a need to examine more carefully the legal and regulatory framework for international capital flows in and out of the country. The Government has improved the monitoring systems for such flows, but the issue requires regional and international effort. The Government should seek every avenue available to address reform of the international financial architecture at the regional and global level.

E. Social Impacts of the Crisis

38. The painful impact of the crisis persisted in 1999. The impact is, however, not adequately reflected in the unemployment data. For example, open unemployment increased from 5.5 percent in August 1998 to 6.3 percent (urban: 10.3 percent; rural: 3.8 percent) in August 1999.[15] The adjustment in the labor market took place through falling real wages rather than rising unemployment. Between August 1997 and August 1998, real wages declined by about 35 percent. They increased significantly in 1999, but were still 20-25 percent below their precrisis levels. However, as bank restructuring is completed and corporate restructuring gathers pace, open unemployment could still increase in the near term before declining.

39. New findings from surveys in 1998 and 1999 have provided substantial additional information on poverty.[16] The present picture reveals a rise in transient or crisis-induced poverty, which peaked in February 1999 at 27.4 percent[17] (urban: 23.9 percent; rural: 29.6 percent) with urban poverty rising somewhat faster than rural poverty. At its peak the crisis plunged additional 17 million people below the poverty line. That so many people could descend into poverty in just over a year demonstrates the vulnerability of the poor to economic crisis in Indonesia. The depth and severity of poverty also increased during the same period indicating that the poor had become poorer, with intensity being somewhat greater in rural areas.[18] However as food prices, especially rice prices, began to decline after February 1999, transient poverty began to abate. While the surge in the incidence of poverty during the crisis

[14] The external debt/GDP ratio was 56 percent in mid-1997 and soared to 93 percent in mid-1998.

[15] Central Bureau of Statistics or Badan Pusat Statistic (BPS)

[16] BPS 100-village survey and the 1998 and 1999 National Socioeconomic Survey, BPS and World Bank Kecamatan Crisis Impact Study, and the Rand Indonesia Family Life Survey 2.

[17] This figure from the 1999 Socioeconomic Survey is still provisional. It is derived from a subsample of the survey. Processing of the entire survey is under way. It is based on a different consumption bundle from the 1996 poverty line and should be compared with 19.2 percent in 1996 (15.6 percent urban and 21.3 percent rural) rather than the often cited 11.3 percent incidence for 1996.

[18] Between February 1996 and February 1999, the poverty gap increased from 2.97 urban and 3.8 rural to 4.7 urban and 6.2 rural. The severity index increased from 0.8 urban and 1.1 rural to 1.4 urban and 1.9 rural during the same period.

may be transitory, its consequences are not. The depletion of assets and savings, the loss of schooling, and the adverse effects of malnutrition cannot be reversed quickly. Even if Indonesia returns to a precrisis level of poverty incidence, 39 million people would still be below the poverty line and many more would be precariously subsisting just above it. Combating poverty is thus the foremost development priority in Indonesia in the post-crisis period.

40. The impact of the crisis at the elementary school level for children aged 7-12 was minimal because of the relatively low cost of such education. The impact was greater at the junior secondary level for children aged 13-15—enrollment dropped by 4-5 percent between February 1997 and December 1998. A higher expected dropout rate seems to have been prevented by a number of factors. First, households borrowed, worked more, and substituted lower quality foods to conserve earnings and keep children in school. Second, the waiving of the requirement for school children to wear uniform also helped.[19] Third and, perhaps most significantly, the Government's scholarship program, strongly supported by ADB and the World Bank, was relatively well targeted reaching a greater proportion of the poor than non-poor.[20]

41. The most recent data on health and nutrition indicate that while the average nutritional status of the entire population improved somewhat, there was a sharp increase in the proportion of infants most seriously at risk, i.e., the proportion which is three standard deviations or more below the international World Health Organization standard. The data also suggest that impacts of the crisis have not been uniform—the most vulnerable, e.g., poor urban and rural households in certain regions, have been very seriously affected.[21] The incidence of severe malnutrition increased more sharply in the rural than in the urban areas. The results of surveys by ADB and others also suggest that the timely response of the Government and its development partners[22] in strengthening the social safety nets seems to have played a major role in averting a serious overall deterioration in the nutritional status of the population. Nevertheless, the crisis has left a large part of the population in a depleted and vulnerable state, and seems to have accentuated social and regional polarization.

II. MEDIUM-TERM REFORM AND POLICY ISSUES

A. Bank Restructuring

42. The mammoth task of bank restructuring made substantial progress in 1999 under difficult sociopolitical conditions. In 1998, the legal framework, institutions, and procedures for restructuring the banking system were initiated and the criteria for recapitalization of private banks were established. The first major step toward recapitalization of private banks was taken in March 1999 with the announcement of eight such banks deemed eligible for recapitalization.

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[19] TA 5799-REG: *Social Impact Assessment of the Financial Crisis in Selected DMCs*, for $500,000, approved on 22 July 1998. Access to scholarships was not asked until later rounds of survey.

[20] Social Monitoring for Economic Recovery Unit working paper Coverage and targeting in the Indonesian Social Safety Net Program: evidence from the 100-village survey, August 1999.

[21] ADB paper presented at the Ninth Meeting of the Consultative Group Meeting on Indonesia, February 2000.

[22] Especially the ADB, World Bank and Japan.

Independent audits of all banks placed them into three categories according to their CAR.[23] All 74 category A banks were to continue in business, but after being subjected to "fit and proper" tests. Thirty-eight of them failed the tests and were placed under BI supervision. Of the category B banks, seven were recapitalized to raise their CARs up to 4 percent. Bank owners provided 20 percent of the total additional capital required, and the Government provided 80 percent. While the recapitalization of private banks greatly increased the Government's stake in the banks, owners have the option of buying back the Government shares by June 2002.

43. As to the seven large state banks, all were in category C. These banks account for nearly 50 percent of the total assets of the banking system. The Government decided to recapitalize these banks in light of their large size, their importance to the economy, and the high costs that would be incurred in case of liquidation. Bank Mandiri was formed by the merger of four of the seven state banks (Bapindo, Bank Bumi Daya, Bank Dagang Negara, and Bank EXIM). The 160 private banks were consolidated into 85. The restructured state and private banks account for about 90 percent of the total commercial banking assets of the country.

44. The acceleration of banking sector reform in early 1999 was welcomed by the financial markets. However, the reform process came to a standstill for several months following the Bank Bali scandal in August 1999. The scandal not only revealed the entrenched nature of corruption in Indonesia, but also cast a shadow over the entire recapitalization process and resolution of interbank claims. The Government finally took steps to investigate the scandal, acted against those responsible, and undertook measures to prevent such incidents in the future thus enabling the reforms to get back on track. This cleared the way for negotiations with the International Monetary Fund (IMF) and completion of an accord on a new extended program.[24] These steps have been welcomed by Indonesia's development partners.

45. The cost of recapitalizing the banking system is estimated at a staggering Rp643 trillion (about $89 billion), or about 60 percent of GDP. The recapitalization was financed by domestic bond issues pushing up domestic public debt to unprecedented levels. Up to end-1999, the total value of bonds issued was estimated at Rp364 trillion. The bonds fall into three categories: (i) variable rate bonds amounting to Rp195.1 trillion, with a quarterly coupon payment equivalent to the interest rate on 3-month SBIs, the bonds consist of 16 series maturing within 3-10 years, designed to cover the negative capital of banks and enable them to reach a CAR of zero percent; (ii) fixed rate bonds valued at Rp8.7 trillion with half-yearly coupon payments, maturing in 5 and 10 years at interest rates of 12 percent and 14 percent, respectively, and designed to increase the CAR of banks from zero to 4 percent; (iii) inflation-indexed bonds, periodically adjusted to CPI, valued at Rp160 trillion, carrying a real interest rate of 3 percent, they are designed to cover the government's liabilities to BI arising from the deposit guarantee program.

[23] Category A: banks with CAR of 4 percent or higher; Category B: banks with CAR of –25 percent to less than 4 percent; Category C: banks with CAR of less than -25 percent. The three categories include 128 private banks, which account for 40 percent of total assets of the banking system. Over 70 banks were closed in the process of restructuring and some face closure.

[24] Negotiations with the IMF took place in November and December 1999, and a new Memorandum of Economic and Financial Policies for the extended facility, amounting to $5 billion (2000-2002), was approved by IMF's Board in January 2000.

46. The recapitalization scheme involves an exchange of government bonds for outstanding shares between the government and the recapitalized bank, and hence required no cash up front. The only initial cost is fiscal—the interest cost of bonds estimated at Rp38 trillion in the FY1999/2000 budget. The fiscal costs will be financed by the proceeds of privatization and assets of IBRA currently valued at about Rp645 trillion. These assets include nonperforming loans (NPLs) and capital assets transferred to IBRA by the banking system. The value of NPLs transferred by banks is estimated at Rp250 trillion—most of it from state banks.

47. The largest banks are state-owned and continue to suffer losses. For example, Bank Mandiri was recapitalized, but experienced further capital erosion due to a negative intermediation margin resulting in a loss of Rp7 trillion in the first two months of operation.[25] IBRA needs to complete the recapitalization and restructuring of the remaining State-owned banks urgently. This is the most important unfinished task in banking sector reforms at present. In the next round of reforms over the medium term, the Government will need to devise a strategy to privatize the banking sector which, as a consequence of recapitalization, is now predominantly state-owned. To improve liquidity, the recapitalized banks have been permitted to trade up to 10 percent of the government bonds issued to them beginning in February 2000. Further sales will be permitted gradually to keep the debt market stable.

48. IBRA also faces a complex challenge in selling off its assets. Such sales are critical in meeting the fiscal costs of restructuring and in reducing the public debt. A major concern is that the market value of IBRA assets could be less than half of the estimated Rp645 trillion. It is not clear whether delaying the sale of assets will raise their market values. More importantly, it is necessary to enhance capital revenues through the sale of these assets quickly to reduce public debt. Over the past year, IBRA has faced severe criticism over its handling of interbank claims, inability to accelerate the sale of assets and inconsistency in implementing banking reforms. IBRA holds the key to restructuring the financial sector and its credibility is critical to sustaining the recovery and restoring market confidence. Recent changes in its top leadership reflect the Government's commitment to strengthen IBRA and enhance its image. However, IBRA's ability to carry forward banking reforms also depends to a significant extent on the decisions of the commercial courts, which adds to the complexity of IBRA's challenges.

49. Indonesia also made further progress in strengthening the legal framework of its financial system in 1999. Based on the revisions of the bankruptcy law and banking law in 1998, regulations issued in May 1999 permit up to 99 percent foreign ownership of local banks. Regulations on the opening of Indonesian offices by foreign banks were also relaxed. Further, the new central bank law transformed BI into an independent entity. Under the law, BI will be the custodian of monetary policy, foreign exchange reserves, and management and operation of the payments system. It prohibits BI from extending any credit to the government. Bank supervision and control presently under BI will be transferred to an independent institution to be established by 2002. Despite the progress so far in reforming the legal framework of the financial sector, much more needs to be done, especially in reforming the capital market, insurance industry, and pension systems. And, it is important to maintain the present momentum to complete these reforms.

[25] August-September 1999.

50. Preliminary findings of an independent audit have raised concerns about BI's financial soundness—mainly the consequence of huge liquidity support extended to individual banks during the crisis, a large part of which was allegedly improperly used. The allegation is being investigated by a Parliamentary subcommittee.

51. The devastating impact of the crisis on the banking system points to a strong need for developing the capital market to mobilize domestic saving and reduce the excessive reliance of commercial enterprises on bank borrowing. The development of a strong bond market is also needed to permit investors to hedge risks, including foreign exchange risks.

B. Corporate Debt Restructuring

52. The Government restructured the Jakarta Initiative Task Force (JITF), IBRA, and the Indonesian Debt Restructuring Agency (INDRA) as avenues for the corporate debtors to seek voluntary resolution of their debt outside the judicial system. Debts not satisfactorily resolved through voluntary mechanisms could be subjected to bankruptcy proceedings via the legal system. Though the institutional framework was well conceived, implementation fell short of expectations. Since its inception in 1998, JITF facilitated the restructuring of only a small number of applications filed with it.[26] Inadequate resources and administrative bottlenecks hampered its operations. The forward foreign exchange cover provided by INDRA to cover restructured deals has not elicited adequate interest from debtors due to the rigid structure of its debt relief scheme. The present strategy for corporate restructuring lacks adequate incentives to encourage creditors and debtors to negotiate restructuring deals speedily, and to accept the implicit losses.

53. In December 1999, the Government established a ministerial committee—the Financial Sector Policy Committee—to enhance the pace of corporate debt restructuring. The Committee will coordinate the operations of all major institutions involved in bank and corporate debt restructuring, i.e., JITF, INDRA, IBRA, BI, and Ministry of Finance. The committee has the flexibility to transfer cases from IBRA to JITF if such cases can be more expeditiously resolved by the latter. Additionally the Committee can, on the recommendation of JITF, withdraw cases from the voluntary settlement mechanism and refer them for bankruptcy proceedings. JITF may make such a recommendation if any given debt restructuring negotiation can not be completed within a specified time frame. These adjustments to the strategy are expected to create stronger incentives for the debtors and creditors to speed up debt workouts. At the same time, transparent guidelines prepared to guide IBRA's decisions concerning debt forgiveness are expected to accelerate IBRA's handling of debt restructuring deals.

54. A key issue in corporate debt restructuring is to strengthen the enforcement of the revised bankruptcy law. Voluntary mechanisms for restructuring corporate debt will have greater appeal if creditors are assured of more credible and expeditious enforcement of the law. Only a limited number of bankruptcy petitions have been filed with the Commercial Court, given the low confidence in and slow pace of the legal processes. Only a few of the cases ended in bankruptcies, and the rulings in most of the cases have been widely criticized.

[26] Of 280 Indonesian companies (total outstanding debt of $23.2 billion and Rp14.6 trillion) that entered into debt negotiations under the JITF framework, only 24 cases covering a total amount of $3.04 billion and Rp2.2 trillion were successfully negotiated by end-1999.

Without rapid progress in corporate debt restructuring growth of the manufacturing sector—the main engine of growth—will remain weak and sentiment of financial markets will not improve, stalling the recovery.

55. Greater Government efforts to address the negative perceptions about governance in judicial processes and to enhance the capacity of the judiciary to implement the bankruptcy law are needed. Credible implementation of the law will remove a major hurdle to corporate debt restructuring in Indonesia. As a step in this direction, in late 1999 the Government announced transparent procedures for the appointment of ad hoc judges from the private sector upon the request of litigants. However this avenue to speed up the court's work has not been used satisfactorily.

C. Governance

56. Decades of unaccountable and centralized administration have degraded the quality and efficiency of public institutions. Strong growth and rising prosperity for two decades before the crisis gave rise to a false sense of complacency, which delayed urgently needed action on governance reforms. Poor governance has resulted in waste of scarce resources. Research results show that a one standard deviation improvement in bureaucratic efficiency could increase average investment rate by 4.3 percent and annual per capita income by 1.3 percentage points.[27] Poor governance reflected in preferential lending to cronies, was responsible in large part for the magnitude of financial collapse and consequent fiscal distress in the wake of the crisis. Credible progress and a firm sense of direction in governance reform are critically needed to restore public trust and investor confidence, and ensure continued support of Indonesia's development partners. Key priorities in improving governance include combating corruption, improving corporate governance, and strengthening public institutions at lower tiers of government to enable effective decentralization. ADB has strongly supported governance reform in Indonesia in all these areas, especially since the crisis.[28] Its future operations will be built on the past work, especially in the areas of anti-corruption, decentralization, and corporate governance.

57. The Government took some important steps in 1999 to combat corruption and passed two new laws. ADB has supported the enactment of these laws, and is now supporting their implementation. The Clean Government Law requires public officials to declare their assets before assuming their posts and to agree to have their assets officially audited during and after their terms. The Law on Eradication of Criminal Acts of Corruption defines corrupt practices of a criminal nature, and establishes the basis for legal prosecution and criminal charges. It also provides for public participation in legal surveillance and the establishment of an independent anticorruption commission for legal enforcement. ADB is assisting the establishment of this commission under its technical assistance. New regulations to reform public procurement and project implementation practices have been issued. These are important steps, although much more remains to be done to reduce the role of the government in economic activities, promote competition, promote efficient, transparent, and accountable public administration, encourage citizen participation, and strengthen legal reform and the role of official oversight agencies. These activities involve progressive institutional change across many sectors and could meet significant resistance from vested interests.

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[27] Mauro, P. 1995. Corruption and Growth, Quarterly Journal of Economics, August.
[28] See Indonesia: Country Assistance Plan, 1999 for details.

58. As in other areas, corporate governance reforms had lagged behind the rapid growth of the economy in the precrisis period. Serious weaknesses in the operational framework of Indonesian corporates were exposed during the crisis. The agenda of reform in corporate governance is substantial. It includes reform of provisions of the Company Law, registration of firms, disclosure of information, protection of shareholders and creditors, improving accounting and auditing standards, rules for listing on the stock markets and regulations on transactions in the capital and securities markets. Corporate governance reform has been a major focus of ADB assistance during the crisis, and will continue to be supported in the future.

59. Parliament's approval of the Law on Regional Autonomy and the Law on Fiscal Balances earlier in 1999 gave impetus to the process of decentralization to districts and provinces. Decentralization is intended to improve accountability of the government's decision-making process, strengthen the participation of beneficiaries, and increase transparency. Implementing the Government's ambitious decentralization agenda—which includes introducing new systems, structures, and procedures to transfer development and administrative functions, and fiscal responsibilities to local levels—will pose difficult challenges. Among other things, this implies that many central Government agencies will need to make their respective mandates consistent with a decentralized framework. It also implies substantial strengthening of the capacity of public institutions, especially at the lower tiers of public administration.

D. Poverty

60. Even before the crisis, Indonesia, despite its impressive record in reducing poverty, had the largest number of poor among ASEAN countries. Recent empirical evidence suggests that transient poverty has abated mainly due to sharply lower food prices and inflation. However, the evidence also provides some stark facts. First, an unacceptably large segment of the population is extremely poor. As indicated earlier, BPS's revised poverty estimates based on a new consumption basket suggests a precrisis (1996) poverty incidence of 19.2 percent. This implies that 39 million people are below the poverty line. In addition, many other than those in absolute poverty are also poor living just above the poverty line. These people—at least another 25 million—lack adequate employment, access to education, health, nutrition and social capital. Second, the country is highly vulnerable to economic shocks. The revised BPS estimates also reveal that at its peak 17 million additional people were plunged below the poverty line. The crisis amply demonstrated that the incidence of poverty can surge and, perhaps more importantly, can reverse gains in social development achieved over decades in a very short period. While the crisis-induced rise in poverty may have subsided, its severe socioeconomic impacts—the deterioration of health, nutrition, education, and economic indicators will linger for many years. Third, large prevailing economic and social inequities, if not adequately and expeditiously addressed, could further aggravate regional and social polarization with potentially serious consequences. Addressing poverty is thus, Indonesia's top development priority.

61. During the crisis, the Government strengthened social safety nets to respond to the poor. Measures were adopted to increase the access of the poor to food and essential health and education services. Although the programs were not immune to allegations of corruption, they seem to have generally met their goals. Over the medium term, however, there is a need to shift the focus of public policy to address structural poverty, while maintaining a much smaller but better targeted safety net program to protect the most vulnerable. Indonesia has a

number of poverty reduction programs, few of which appear to have worked well.[29] A major drawback of the earlier programs appears to be their top-down approach, insistence on subsidies, and lack of accountability. These need to be carefully reviewed and restructured to reduce poverty more effectively.

62. The new Government has expressed strong commitment to addressing poverty reduction. The policy of decentralization is in major part aimed at addressing regional economic disparities and improving poverty targeting. The policy will enable these issues to be addressed much more directly and sensitively especially with functioning democratic institutions. Possibilities to empower the poor, mobilize their creative energies, and initiate a genuine partnership between government, civil society, and the poor to eradicate poverty will be enhanced. Good governance will also support poverty reduction by addressing corruption and inefficiency in delivering public services to the poor. The challenge over the medium to long term will be to realize the potential that decentralization holds to reduce poverty. The first step toward this end is to develop a workable strategy quickly and initiate its implementation, beginning with the worst pockets of poverty.

E. Public Debt

63. A serious consequence of the crisis has been the massive buildup of public debt. At end-1997 public debt was estimated at $53 billion or 23 percent of GDP. By end-1998, it had increased to 60 percent; and by the time the bond issues for bank recapitalization are completed in March 2000 public debt is forecast to increase to $152 billion, or about 95 percent of GDP.[30] Contrary to public perception, about 75 percent of the rise in public debt was contributed by domestic bond issues to recapitalize banks and repay BI's liquidity support to the banking system in the early period of the crisis. Other major factors include much larger official external borrowing and the combined effects of rupiah depreciation and contraction of real GDP. Domestic debt was not a source of budget financing prior to the crisis, but it has become the more important source after the crisis. Domestic public debt is presently estimated at $89 billion compared with an external public debt of $63 billion. The crisis has raised external public debt only $10 billion—from $53 billion at end-March 1997 to $63 billion at end-March 2000. About half of the rise in the external public debt was due to appreciation of the yen. Nearly 40 percent of Indonesia's external debt is yen-denominated.

64. Total public debt service payments absorbed 24 percent of total tax revenues prior to the crisis, but are estimated to absorb 40 percent in FY1999/2000, or about 3.7 percent of GDP. This is forecast to rise to 54 percent in FY2000. The Paris Club rescheduling expected in April 2000 will, however, reduce the debt burden substantially. The external debt service payment is projected to decline to 25 percent in 2002. Annual external debt service payments are estimated at $7.5 billion in FY1999/2000. This indicates a need for careful programming of external assistance to prevent negative resource transfers at this nascent phase of the economic recovery. However, negative net resource transfers are expected as the recovery gains momentum and fiscal sustainability is achieved over the medium term.

65. Domestic debt service obligations have almost doubled the fiscal burden. Bond issues will require interest payments of about $6 billion, i.e., 4 percent of GDP, excluding the inflation-indexed bonds issued to BI, as these are capitalized. In addition, projected maturities will rise

[29] For more details, see PED Indonesia Poverty Assessment, ADB. February 2000 (mimeo).
[30] World Bank public debt study under preparation, to which ADB also contributed.

to $7.8 billion in 2004 and $9 billion in 2008. The total debt/GDP ratio is likely to remain above 40 percent until 2004. Therefore, total external and domestic debt service obligations will absorb a substantial share of public revenues, constraining development resources for almost a decade.

66. Public debt is technically sustainable if the debt/GDP ratio declines over time. The debt study suggests that this is the case in Indonesia. The projections suggest that the debt-GDP ratio will decline from 95 percent at present to less than 60 percent within 4 years, and drop below 40 percent within 10 years. The critical assumptions in this scenario pertain to further real exchange rate appreciation, large IBRA asset sales, primary fiscal surpluses (public savings), return to 5-6 percent GDP growth from 2002 onward, and no further recourse to debt creation to offset losses on off-budget items. Delays in returning to strong growth, and in the sale of IBRA assets, losses on off-budget funds and continued "bleeding" of state-owned banks pose the most risks to the realization of the scenario.

67. The projected trajectory of debt reduction is ambitious, but achievable. There is no simple solution to the debt problem. Managing the massive fiscal debt requires sound macroeconomic management and bold policy actions. These include macroeconomic policies supportive of economic growth, aggressive sale of IBRA assets and privatization to boost capital revenues, neutralization of distorted incentives to win back the confidence of foreign investors, fiscal reforms to raise revenues, reducing off-budget risks, containing contingent liabilities, and political stability. Such a debt management strategy also highlights the critical need to strengthen governance.

F. Political Developments

68. The complex political transition, which began with the departure of former President Suharto in May 1998, reached its first major landmark in June 1999 with the election of Parliament—the first democratic one in 44 years. The political transition was completed with the election of the President and Vice-President in October 1999. The entire process unfolded under conditions of extraordinary social and economic stress and, contrary to speculation, was completed peacefully. This had a highly positive impact on financial markets and the international community: foreign capital reflows, the equity market, and the exchange rate rebounded in the second half of 1999.

69. These positive developments notwithstanding, Indonesia is going through a traumatic period of "soul-searching," following a long period of authoritarian rule. The process often resulted in violent events. In the past, a highly centralized administration, characterized by weak governance was unable to respond to local development aspirations. Avenues for expression of such aspirations were curbed. The result was the buildup, over three decades, of deep fissures along social, ethnic, regional, religious, political, and economic lines. The economic crisis aggravated these tensions and with the ushering of democracy and a free press, they not only came to light, but often erupted in violent conflict in ways not seen in Indonesia since the 1960s.

70. The regional tensions in particular pose difficult problems for Indonesia. However, the new Government is firmly committed to resolving these complex issues in a peaceful and democratic manner, guided by the rule of law. While it is important to take advantage of this window of opportunity, it is equally important to understand that such complex issues will take time to resolve, especially in a country with such great sociocultural diversity. Although the

political transition has been completed peacefully, the transition to democracy is still in its infancy. In a country where democratic institutions did not have a chance to evolve, they will take time to grow. To avoid a lapse into a vicious cycle of social instability and poor economic performance, economic recovery must gather momentum and issues of regional economic disparity must be addressed urgently. Indonesia's challenges are doubtless complex, but the Government has made a good beginning in meeting them.

III. SHORT-TERM ECONOMIC PROSPECTS

71. Economic recovery is expected to gain momentum as aggregate demand, driven mainly by domestic consumption, picks up in 2000. Although investment could remain weak, exports are forecast to increase. Fueled by domestic consumption and an upturn in exports, the recovery in 2000 will be underpinned by a rebound in manufacturing activity. Along with full recovery of agriculture and positive growth of services, the upturn in manufacturing will permit an overall growth of 4 percent (Table 5). However, given that actual output is still well below its potential level, overall GDP could grow up to 5 percent in 2000, if export rebound is strong and the financial sector stabilizes. Overall GDP growth is forecast at 5 percent in 2001, although with higher capacity utilization it could reach up to 6 percent.

72. A budget deficit is forecast over the short term, but it will decline from 5 percent of GDP in 2000 to 3 percent in 2001 as rising private sector activity pushes up revenues while outlays on subsidies decline. Imports are forecast to increase in 2000 as domestic demand becomes more buoyant, lowering the current account surplus to 2.2 percent of GDP, and further to 0.5 percent in 2001. The import coverage of reserves will drop below six months in 2000, declining further to four months in 2001. The debt/GDP ratio is expected to decline gradually during the forecast period due to higher GDP growth, falling interest rates, and increased privatization and asset recovery by IBRA.

73. Inflation is likely to exceed the Government forecast of 5 percent in 2000, and to reach 6 percent due to increases in wages and salaries, upward adjustments in fuel and electricity prices, and the tariffs on rice and sugar. Inflation will, however, decline to below 5 percent in 2001. With greater macroeconomic stability and adequate reserve cover, the exchange rate should remain in the range of Rp7,000-Rp7,500/$ in 2000, but will be vulnerable to swings in market sentiment. However, with strong export growth and net inflows of private foreign capital in 2001, it could drop below Rp7,000 per dollar. The SBI interest rate is likely to drop from an average of 23 percent in 1999 to 11 percent in 2000.

74. Critical to the forecast of GDP growth and macroeconomic indicators for 2000 and 2001 are the assumptions that domestic political conditions in Indonesia will not deteriorate and that East Asia's strong rebound, especially that of Japan's, will continue. The pace of economic recovery will also critically depend on rapid progress in corporate debt restructuring and rehabilitation of the financial sector.

75. The newly elected Parliament quickly presented a vision for Indonesia's development—a united Indonesia based on democracy and the rule of law, and a strong economy with increasing prosperity for all Indonesians.[31] The Government must now swiftly translate the vision into a concrete and cohesive development program. Although Indonesia faces difficult

[31] Guidelines for State Policy, issued by Parliament, November 1999.

development challenges, its economic foundations are strong—its precrisis per capita GDP exceeded $1,000 and its precrisis record of strong economic growth over two decades, coupled with sharp reduction in poverty is matched by few countries. Whether Indonesia can speed up recovery and return to strong and equitable growth is as much a matter of solid political leadership as it is of sound economic management.

Table 5: Key Economic Indicators - Short-Term Projections[a]

Sector	1998	1999	2000	2001
Gross Domestic Product (% growth)	-13.2	0.2	4.0	5.0
Agriculture	0.8	0.7	3.0	3.5
Industry	-15.1	1.7	5.7	6.5
Mining and quarrying	-3.1	-0.1	3.0	3.8
Manufacturing	-11.9	2.2	6.5	7.0
Construction	-40.5	1.1	5.5	7.5
Electricity, gas, and water	1.9	7.3	10.0	10.0
Services	-16.2	-1.5	2.6	4.0
Savings and Investment (% of GDP)				
Gross Domestic Investment (GDI)	19.1	11.6	13.0	17.5
Gross National Savings (GNS)	23.2	13.2	15.2	18.0
Resource Gap (GNS-GDI)	4.1	3.5	2.2	0.5
Money and Prices (% growth)				
Domestic Liquidity (M2)	62.3	11.9	13.0	17.0
GDP Deflator	84.0	10.2	5.5	4.2
Consumer Price Index	58.5	20.5	6.0	5.0
Fiscal Indicators (% of GDP) [b]				
Revenues	15.1	15.1	17.3	17.9
Overall Balance	-3.7	-2.3	-5.0	-3.1
External Accounts				
Exports ($ million)	50,371	46,655	50,434	54,973
%growth	-10.5	-7.4	8.1	9.0
Imports ($ million)	31,942	28,481	30,617	34,903
% growth	-30.9	-10.8	7.5	14.0
Current Account Balance ($ million)	4,097	4,904	3,819	936
% of GDP	4.1	3.5	2.2	0.5

[a] Staff forecasts.

[b] The 1998 and 1999 figures refer to data for fiscal year 1998/99 and 1999/2000, respectively.

APPENDIX

Table A1: Key Macroeconomic Indicators, 1994-1999

Item	1994	1995	1996	1997	1998	1999
A. Income and Growth						
1. GDP per Capita ($, current)	928	1,043	1,155	1,073	468	675
2. GDP Growth (%, in constant prices)	7.5	8.2	7.8	4.7	-13.2	0.3
Agriculture	0.6	4.4	3.1	1	0.8	0.7
Industry	11.2	10.4	10.7	5.2	-15.1	1.7
o/w manufacturing	12.4	10.9	11.6	5.3	-11.9	2.2
Services	7.1	7.6	6.8	5.6	-16.2	-1.5
B. Saving and Investment (current, % of GDP)						
1. Gross National Saving	29.4	28.6	27.3	29.4	23.2	15.1
2. Gross Domestic Investment	31.1	31.9	30.7	31.8	19.1	11.6
C. Money and Inflation (annual % change)						
1. Consumer Prices (average)	8.5	9.4	7.9	6.6	58.4	20.5
2. Broad Money (M2)	20.2	27.6	29.6	23.2	62.3	11.9
D. Government Finance (% of GDP) [a]						
1. Revenues	16.6	15.5	15.8	15.7	15.1	15.1
2. Expenditures	16.2	14.9	15.6	15.7	18.8	17.4
3. Overall Surplus/Deficit (-)	0.4	0.6	0.2	0	-3.7	-2.3
E. Balance of Payments						
1. Merchandise Trade Balance (% of GDP)	4.5	3.2	2.6	4.7	18.4	12.9 [b]
2. Current Account Balance ($ million)	-2,960	-6,760	-7,801	-5,001	4,097	4,904 [b]
3. Current Account Balance (% of GDP)	-1.7	-3.3	-3.4	-2.3	4.1	3.5 [b]
4. Exports, $ (annual % change)	9.9	18.0	5.8	12.2	-10.5	-7.4 [b]
5. Imports, $ (annual % change)	13.9	26.6	8.1	4.5	-30.9	-10.8 [b]
F. External Payments Indicators [a]						
1. Gross Foreign Assets ($ million)	17,139	20,554	26,612	16,509	25,742	27,305 [c]
(months of nonoil imports)	6.1	5.9	7	4.6	10.1	8.6 [b]
2. External Debt Service (% of exports of goods & services)	32.6	32.6	34.2	37.8	39.1	34.8
3. External Debt (% of GDP)	58.1	51.9	56	73.4	141.9	103
Memorandum Items						
1. GDP (current, Rp trillion)	382	455	532.6	628	1,002	1,107
2. Exchange Rate (Rp per $, annual average)	2,160.8	2,248.6	2,342.3	2,909.4	10,013.7	7,852.9

GDP = gross domestic product; o/w = of which; na = not available.

[a] [c] Fiscal year data beginning April, e.g., 1994 data refers to FY1994/95, and so on.

[b] Staff estimates.

[c] Ending December 1999.

Table A2.1: Gross Domestic Product by Sectoral Origin in Constant Prices, 1994-1999

Sector	1994	1995	1996	1997	1998	1999 Revised Estimates
			(Rp. billion)			
Agriculture	59,291	61,885	63,828	64,468	64,988	65,424
Farm Food Crops	31,408	32,952	33,647	32,688	33,311	33,768
Nonfood Crops	9,472	9,912	10,355	10,497	10,787	11,138
Livestock Products	6,451	6,790	7,133	7,483	6,954	6,957
Forestry	6,301	6,304	6,444	7,190	7,057	6,482
Fishery	5,660	5,928	6,249	6,610	6,880	7,079
Industry	145,471	160,629	177,800	186,994	158,818	161,503
Mining and Quarrying	33,262	35,502	37,739	38,538	37,353	37,312
Oil and Natural Gas	23,720	23,720	24,063	23,920	23,417	22,409
Others	9,542	11,782	13,677	14,618	13,936	14,902
Manufacturing	82,649	91,637	102,260	107,630	94,847	96,928
Oil and Natural Gas	10,269	9,782	10,864	10,650	10,817	11,477
Nonoil/Gas	72,380	81,855	91,396	96,979	84,030	85,451
Electricity, Gas, and Water	3,703	4,292	4,877	5,480	5,582	5,987
Construction	25,858	29,198	32,924	35,346	21,035	21,277
Services	149,879	161,278	172,171	181,783	152,246	149,976
Trade, Hotel, and Restaurant	59,504	64,231	69,475	73,524	60,253	59,592
Transport and Communications	25,189	27,329	29,701	31,783	26,975	26,782
Finance	30,901	34,313	36,384	38,543	28,279	25,826
Other Services	34,285	35,406	36,610	37,934	36,739	37,776
Gross Domestic Product	354,641	383,792	413,798	433,246	376,052	376,902
of which:						
Nonoil/Gas	320,652	350,290	378,871	398,675	341,817	343,016
Oil and Natural Gas	33,988	33,502	34,927	34,570	34,234	33,886
			(Percent Growth Rate)			
Agriculture	0.6	4.4	3.1	1.0	0.8	0.7
Industry	11.2	10.4	10.7	5.2	-15.1	1.7
Mining and Quarrying	5.6	6.7	6.3	2.1	-3.1	-0.1
Manufacturing	12.4	10.9	11.6	5.3	-11.9	2.2
Oil and Natural Gas	4.9	-4.7	11.1	-2.0	1.6	6.1
Nonoil/Gas	13.5	13.1	11.7	6.1	-13.4	1.7
Electricity, Gas, and Water	12.5	15.9	13.6	12.4	1.9	7.2
Construction	14.9	12.9	12.8	7.4	-40.5	1.1
of which						
Nonoil/Gas	8.0	9.2	8.2	5.2	-14.3	0.4
Oil and Natural Gas	3.3	-1.4	4.3	-1.0	-1.0	-1.0
Services	7.1	7.6	6.8	5.6	-16.2	-1.5
Gross Domestic Product	7.5	8.2	7.8	4.7	-13.2	0.2
of which:						
Nonoil/Gas	8.0	9.2	8.2	5.2	-14.3	0.4
Oil and Natural Gas	3.3	-1.4	4.3	-1.0	-1.0	-1.0

Source: Central Bureau of Statistics.

Table A2.2: Gross Domestic Product by Sectoral Origin in Current Prices, 1994-1999
(Rp. billion)

Sector	1994	1995	1996	1997	1998	1999 Revised Estimates
Agriculture	66,072	77,896	88,792	101,010	181,021	214,879
Farm Food Crops	34,941	42,200	47,622	52,189	91,200	113,154
Nonfood Crops	10,587	12,667	14,435	16,447	33,727	37,637
Livestock Products	7,102	8,079	9,524	11,688	17,781	21,421
Forestry	6,897	7,390	8,171	9,807	17,098	17,278
Fishery	6,544	7,561	9,041	10,878	21,214	25,388
Industry	155,342	189,991	231,432	278,251	449,780	474,680
Mining and Quarrying	33,507	40,195	46,088	55,562	137,629	109,646
Oil and Natural Gas	23,070	25,410	28,118	34,037	83,633	68,068
Others	10,437	14,785	17,970	21,525	53,996	41,578
Manufacturing	89,241	109,689	136,426	168,178	245,411	285,513
Oil and Natural Gas	10,439	11,399	14,194	15,622	29,437	27,473
Nonoil/Gas	78,802	98,290	122,232	152,556	215,974	258,041
Electricity, Gas, and Water	4,577	5,655	6,893	7,832	11,149	13,160
Construction	28,017	34,452	42,025	46,679	55,591	66,360
Services	160,806	186,627	212,345	248,435	371,533	417,733
Trade, Hotel, and Restaurant	63,859	75,640	87,137	99,582	167,117	182,818
Transport and Communications	27,353	30,795	34,926	38,531	51,937	66,077
Finance, Rental, & Business Services	34,506	39,510	43,982	54,360	70,007	70,432
Other Services	35,089	40,682	46,299	55,962	82,472	98,406
Gross Domestic Product	382,220	454,514	532,568	627,696	1,002,333	1,107,291
of which						
Nonoil/Gas	348,711	417,706	490,255	578,037	889,263	1,011,751
Oil and Natural Gas	33,509	36,808	42,313	49,658	113,070	95,541

Source: Central Bureau of Statistics

Note: Prior to 1993, finance,rental & business services includes only banking & finance and ownership of dwellings.

Table A3.1: Expenditures on Gross Domestic Product in Constant 1993 Prices, 1994-1999

Item	1994	1995	1996	1997	1998	1999 Revised Estimates
			(Rp. billion)			
Consumption	238,505	265,096	288,698	308,817	294,741	298,882
Private	208,062	234,245	257,016	277,116	267,913	271,867
Government	30,443	30,851	31,681	31,701	26,828	27,014
Gross Investments	113,425	128,239	134,572	143,067	79,005	64,755
Gross Fixed Capital Formation	98,589	112,386	128,699	139,726	90,071	71,351
Changes in Stock	14,836	15,853	5,873	3,342	-11,066	-6,596
Exports of Goods and Nonfactor Services	97,002	104,492	112,391	121,158	134,707	91,518
Less: Imports of Goods and Nonfactor Services	94,291	114,035	121,863	139,796	132,401	78,252
Gross Domestic Product	354,641	383,792	413,798	433,246	376,052	376,902
Net Factor Income from Abroad	-9,730	-11,924	-12,487	-15,463	-27,965	-22,134
Gross National Product	344,911	371,869	401,311	417,783	348,086	354,768
Less: Net Indirect Taxes	23,106	23,210	22,470	26,100	1,624	7,772
Less: Depreciation	17,732	19,190	20,690	21,662	22,289	18,845
National Income	304,073	329,469	358,152	370,021	324,174	328,152
GDP Deflator (1993=100)	108	118	129	145	267	294
GNP Deflator (1993=100)	108	119	129	146	272	290
			(Percent Growth Rate)			
Consumption	7.1	11.1	8.9	7.0	-4.6	1.4
Private	7.8	12.6	9.7	7.8	-3.3	1.5
Government	2.3	1.3	2.7	0.1	-15.4	0.7
Gross Investments	16.7	13.1	4.9	6.3	-44.8	-18.0
Gross Fixed Capital Formation	13.8	14.0	14.5	8.6	-35.5	-20.8
Changes in Stock	40.7	6.9	-63.0	-43.1	-431.2	-40.4
Exports of Goods and Nonfactor Services	9.9	7.7	7.6	7.8	11.2	-32.1
Less: Imports of Goods and Nonfactor Services	20.3	20.9	6.9	14.7	-5.3	-40.9
Gross Domestic Product	7.5	8.2	7.8	4.7	-13.2	0.2
Net Factor Income From Abroad	-22.5	22.5	4.7	23.8	80.9	-20.9
Gross National Product	8.7	7.8	7.9	4.1	-16.7	1.9

Source: Central Bureau of Statistics.

Table A3.2: Expenditures on Gross Domestic Product in Current Prices, 1994-1999
(Rp. billion)

Item	1994	1995	1996	1997	1998	1999 Revised Estimates
Consumption	259,133	315,461	372,394	430,123	717,876	891,564
Private Consumption	228,119	279,876	332,094	387,171	663,460	818,933
Government Consumption	31,014	35,584	40,299	42,952	54,416	72,631
Gross Investments	118,707	145,118	163,453	199,301	191,271	128,242
Gross Fixed Capital Formatior	105,381	129,218	157,653	177,686	221,364	214,186
Changes in Stock	13,327	15,900	5,800	21,615	-30,093	-85,944
Exports of Goods and Nonfactor Services	101,332	119,593	137,533	174,871	506,245	387,952
Less: Imports of Goods and Nonfactor Services	96,953	125,657	140,812	176,600	413,058	300,467
Gross Domestic Product	382,220	454,514	532,568	627,695	1,002,333	1,107,291
Net Factor Income From Abroad	-10,248	-13,366	-14,272	-18,355	-53,894	-78,856
Gross National Product	371,971	441,148	518,296	609,340	948,439	1,028,435
Less: Net Indirect Taxes	24,721	27,487	28,919	37,829	-4,102	22,543
Less: Depreciation	19,111	22,726	26,628	31,385	49,479	55,365
National Income	328,140	390,936	462,749	540,126	903,063	950,527

Source: Central Bureau of Statistics.

Table A4: Domestic Investments and Gross National Savings, 1994-1999
(percent of gross domestic product)

Item	1994	1995	1996	1997	1998	1999[a]
Gross Domestic Investment (GDI)	31.1	31.9	30.7	31.8	19.1	11.6
Gross Fixed Investment	27.6	28.4	29.6	28.3	22.1	19.3
Gross National Saving (GNS)[b]	29.4	28.6	27.3	29.4	23.2	15.1
Gross Domestic Saving (GDS)[c]	32.1	31.5	29.9	32.4	28.6	22.2
Private	26.2	26.6	25.2	28.6	28.0	20.7
Public[d]	5.8	5.0	4.7	3.8	0.5	1.5
Resource Gap (GNS-GDI)	-1.7	-3.3	-3.4	-2.3	4.1	3.5
Memo Items:						
Gross Domestic Product in Current Prices (Rp billion)	382,220	454,514	532,568	627,695	1,002,333	1,107,291

[a] Advance estimates.
[b] Computed as the sum of GDS and the net factor income from abroad.
[c] Computed as the sum of GDI and the current account balance (excluding current transfers) minus net factor income from abroad.
[d] Refers to domestic revenues less routine expenditures in the budget. The 1999 figure was based on the budget for FY1999/2000.
Source: Central Bureau of Statistics and Ministry of Finance.

Table A5: Factors Affecting Domestic Liquidity, 1994-1999

Item	1994	1995	1996	1997	1998	1999
			(Rp. billion)			
Net Foreign Assets	35,276	50,503	112,930	186,989	141,677	129,096
Net Domestic Assets	149,240	190,012	237,991	287,658	435,704	517,109
Net Domestic Credits	191,751	233,088	286,725	407,301	524,235	649,833
Claims on Public Sector	-9,308	-15,345	-13,476	-24,931	-1,029	416,119
Government (net)	-18,828.00	-26,300.00	-29,057.00	-45,543.00	-28,030.00	397,257
Public Enterprises[a]	9,520	10,955	15,581	20,612	27,001	18,862
Claims on Private Sector	201,059	248,433	300,201	432,232	525,264	233,714
Other Assets (net)	-42,511	-43,076	-48,734	-119,643	-88,531	-132,724
Broad Money	174,512	222,638	288,632	355,643	577,381	646,205
Narrow Money	45,374	52,677	64,089	78,343	101,197	124,633
Currency	18,634	20,807	22,487	28,424	41,394	58,353
Demand Deposits	26,740	31,870	41,602	49,919	59,803	66,280
Quasi Money	129,138	169,961	224,543	277,300	476,184	521,572
Rp Time and Savings Deposits	98,372	130,891	174,968	186,311	358,649	408,580
Foreign Currency Deposits	30,766	39,070	49,575	90,989	117,535	112,992
			(Percent Growth)			
Net Foreign Assets	34.8	43.2	123.6	65.6	-24.2	-8.9
Net Domestic Assets	29.2	27.3	25.3	20.9	51.5	18.7
Net Domestic Credits	20.5	21.6	23.0	42.1	28.7	24.0
Claims on Public Sector	-125.0	-64.9	12.2	-85.0	95.9	40,539.2
Government (net)	-33.1	-39.7	-10.5	-56.7	38.5	1,517.3
Public Enterprises[a]	-4.8	15.1	42.2	32.3	31.0	-30.1
Claims on Private Sector	23.2	23.6	20.8	44.0	21.5	-55.5
Other Assets (net)	2.4	-1.3	-13.1	-145.5	26.0	-49.9
Broad Money	20.2	27.6	29.6	23.2	62.3	11.9
Narrow Money	23.3	16.1	21.7	22.2	29.2	23.2
Currency	29.1	11.7	8.1	26.4	45.6	41.0
Demand Deposits	19.5	19.2	30.5	20.0	19.8	10.8
Quasi Money	19.1	31.6	32.1	23.5	71.7	9.5
Rp Time and Savings Deposits	18.6	33.1	33.7	6.5	92.5	13.9
Foreign Currency Deposits	20.9	27.0	26.9	83.5	29.2	-3.9

[a] Claims on the public enterprises exclude claims on financial cnterprises by Bank Indonesia. Since April 1993, includes nonbank financial institutions.

Source: Indonesian Financial Statistics, Bank Indonesia.

Table A6: Consumer Price Indices, 1995-1999[a]

						1999											
Item	**1995**	**1996**	**1997[b]**	**1998**	**1999**	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Consumer Price Index																	
All Items	172.3	185.9	106.2	168.3	202.8	204.5	207.1	206.8	205.3	204.8	204.1	201.9	200.1	198.7	199.0	199.0	202.5
Foodstuffs	171.1	187.4	108.7	209.2	261.5	281.1	287.6	281.7	275.1	271.4	268.3	259.0	248.5	239.1	237.2	240.0	249.5
Prepared Food, Softdrinks, and Tobacco	-	-	105.2	173.9	215.9	213.8	216.9	216.3	215.5	215.2	215.2	214.9	215.3	216.3	216.1	216.5	219.2
Housing	185.1	194.8	105.5	142.0	164.8	160.6	162.1	162.9	164.0	164.9	165.3	166.1	165.9	166.1	166.5	165.9	166.8
Clothing	153.6	164.0	104.2	191.7	230.7	232.1	234.2	234.7	233.6	231.2	228.3	224.7	226.6	229.6	232.2	228.4	233.2
Health	-	-	108.5	179.5	218.1	214.1	214.1	215.8	216.6	217.6	218.2	219.5	221.0	220.0	220.1	220.0	220.4
Education, Recreation, and Sports	-	-	109.1	147.0	165.3	161.4	161.9	162.1	162.0	162.6	163.1	163.9	166.5	169.5	170.2	170.4	170.4
Transportation and Communications	-	-	103.7	145.1	169.4	165.0	164.3	169.2	169.1	170.1	170.2	169.9	169.7	169.9	171.3	171.6	172.2
Miscellaneous	168.4	184.6															
Inflation Rate (percent growth from the same period in previous year)																	
All Items	9.4	7.9	6.6	58.4	20.5	70.7	53.4	45.4	38.0	30.7	24.5	13.5	5.8	1.2	1.7	1.6	1.9
Foodstuffs	13.2	9.5	8.8	92.5	25.0	110.9	82.3	68.9	55.8	48.0	36.6	17.6	3.4	-8.4	-7.4	-6.1	-5.2
Prepared Food, Softdrinks, and Tobacco				65.3	24.1	86.8	63.4	52.1	40.7	35.1	28.1	16.8	7.7	5.0	4.3	3.8	3.6
Housing	8.8	5.2	4.2	34.7	16.0	41.2	31.5	26.7	24.7	20.4	18.8	13.0	8.1	6.5	5.8	4.9	4.9
Clothing	6.3	6.8	5.0	83.9	20.4	82.3	61.4	45.4	38.7	31.3	16.9	2.5	0.4	2.0	5.1	5.7	6.1
Health				65.4	21.5	72.3	43.7	38.4	32.0	29.5	26.9	17.7	11.6	7.6	5.5	4.4	3.7
Education, Recreation, and Sports				34.7	12.4	32.7	22.8	20.3	18.5	17.2	15.8	8.9	3.9	4.5	4.5	5.0	5.3
Transportation and Communications				39.9	16.7	48.1	39.4	41.3	34.6	15.4	13.2	9.2	6.2	4.1	4.7	4.9	5.2

[a] The consumer price index (CPI) prior to 1997 was based on the cost of living survey conducted in March 1988-April 1989 in 27 provincial capital cities for 200-224 commodities classified into four groups. Beginning in 1997, the CPI was based on the survey of cost of living conducted in 1996 in 27 provincial capital cities and 17 country capital cities for 249-353 commodities classified into seven groups.

[b] The inflation rates in 1997 are based on the old series.

Source: Central Bureau of Statistics.

Table A7: Balance of Payments, 1994-1999
($ million)

Transaction	1994	1995	1996	1997	1998	Forecast 1999
A. Current Account	-2,960	-6,760	-7,801	-5,001	4,097	4,904
1. Merchandise	7,901	6,533	5,948	10,074	18,429	18,174
Exports, FOB	40,223	47,454	50,188	56,297	50,371	46,655
Nonoil/gas	30,292	36,969	38,021	44,576	42,951	38,020
Oil/gas	9,931	10,485	12,167	11,721	7,420	8,635
Imports, FOB	32,322	40,921	44,240	46,223	31,942	28,481
Nonoil/gas	28,697	37,065	39,870	41,447	29,087	24,986
Oil/gas	3,625	3,856	4,370	4,776	2,855	3,495
2. Services, Net	-10,861	-13,293	-13,749	-15,075	-14,332	-13,270
Nonoil/gas	-7,973	-10,207	-10,249	-10,525	-11,420	-10,571
Oil/gas	-2,888	-3,086	-3,500	-4,550	-2,912	-2,699
B. Capital Account, Excluding Reserves	4,008	10,589	10,989	5,578	-3,874	-2,827
Official Transfer & Capital, Net	307	336	-522	5,916	9,971	6453
a. Official inflows	5,697	5,785	5,693	7,594	7,414	-
CGI	5,353	5,627	5,055	7,594	5,897	-
Non-CGI (Project aid)	344	158	638	0	1517	-
b. Amortization	5,390	5,449	6,215	4,714	3,765	-
c. Exceptional financing				3,036	6,322	-
c. Private Capital, Net	3,701	10,253	11,511	-338	-13,845	-9,280
Direct Investment	2,108	4,346	6,194	4677	-356	-
Others	1,593	5,907	5,317	-5,015	-13,489	-
C. Overall Balance	1,048	3,829	3,188	577	223	2077
D. Net Errors and Omissions	-242	-2,313	1,264	-5,022	2,121	1,821
E. Change in Reserves[a]	-806	-1,516	-4,452	4,445	-2,344	-3,898
Current Account/GDP (%)	-1.7	-3.3	-3.4	-2.3	4.1	3.5
Merchandise Trade Balance/GDP (%)	4.5	3.2	2.6	4.7	18.4	12.9
Exports, FOB, % growth	9.9	18.0	5.8	12.2	-10.5	-7.4
Imports, FOB, % growth	13.9	26.6	8.1	4.5	-30.9	-10.8

FOB = freight-on-board; CGI = Consultative Group on Indonesia.
[a] Negative is for surplus and positive is for deficit.
Source: Bank Indonesia.

Table A8: External Debt and Debt Service Payments, FY1994-June 1999
($ million)

Item	Mar 94	Mar 95	Mar 96	Mar 97	Mar 98	Mar 99	Jun 99
A. Outstanding External Debt [a]	83,299	101,278	106,455	113,143	138,018	149,849	144,949
By Maturity	83,299	101,278	106,455	113,143			144,949
Medium- and Long-Term	74,869	93,163	97,438	98,754			113,476
Short-Term Debt	8,430	8,115	9,017	14,389			31,473
By Debtor	83,299	101,278	106,455	113,143	138,018	149,849	144,949
Public Sector	60,219	67,578	63,513	56,281	65,564	78,445	80,656
Government	55,037	62,569	58,610	52,635	54,388	68,433	70,692
Public Enterprises	5,182	5,009	4,903	3,646	5,569	5,217	5,021
o/w Pertamina Nonrecourse Projects	4,460	4,368	4,304	3,169			
o/w Bank credit					3,842	4,123	4,121
Domestic securities issued to nonresidents					1,727	1,094	900
State Banks					5,607	4,794	4,944
o/w Bank credit					5,024	4,782	4,927
Domestic securities issued to nonresidents					583	12	17
Private Sector	23,080	33,700	42,942	56,862	72,454	71,405	64,293
Banks	8,207	9,017	8,930	9,622	7,996	6,876	5,723
o/w Bank credit					7,802	6,876	5,705
Dom. Sec. To nonresidents					194	0	18
Nonbanks	14,873	24,683	34,012	47,240	64,458	64,529	58,570
o/w Bank credit					60,760	62,174	56,127
Dom. Sec. To nonresidents					3,698	2,355	2,443
By Creditor	83,299	101,278	106,455	113,144			
Public Sector	60,219	67,578	63,513	56,282			
Suppliers' Credits	874	1,017	1,015	779			
Financial Institutions	15,554	17,607	16,477	15,171			
Bonds	99	99	26	426			
Multilateral Institutions	17,639	19,074	19,328	16,451			
Bilateral Institutions	21,503	25,317	22,283	20,226			
Nationalization	90	96	80	60			
Pertamina Nonrecourse Projects	4,460	4,368	4,304	3,169			
Private Sector	23,080	33,700	42,942	56,862			
B. Debt Service Payments	13,317	15,846	18,045	20,691			
Amortization on Principal	8,927	10,295	11,779	14,406			
Public Sector	5,503	5,897	6,420	7,850			
Government	5,132	5,546	5,939	6,118	4,095	2,898	
Public Enterprises	371	351	481	1,732			
o/w Pertamina Nonrecourse Projects	344	305					
Private Sector	3,424	4,398	5,359	6,556	32,078	36,887	
Bank					2,844	3,107	
Nonbank					29,234	33,780	
Interest Payments	4,390	5,551	6,266	6,285			
Public	3,117	3,421	3,450	3,047			
Government	2,843	3,060	3,133	2,723	2,467	2,871	
Others	274	361	317	324			
Private Sector	1,273	2,130	2,816	3,238	9,091	10,124	
Bank					913	690	
Nonbank					8,178	9,434	
Memorandum Items							
GDP in Current Prices, (Fiscal Year)	156,842	174,399	205,000	231,875			
Exports of Goods and Services (EXGS)	41,772	48,631	55,287	60,457			
Total Debt/GDP	53.1	58.1	51.9	56.0			
Total Debt / EXGS	199.4	208.3	192.5	187.1			
Debt Service Payments / EXGS	31.9	32.6	32.6	34.2			
Principal Amortization / EXGS	21.4	21.2	21.3	23.8			
Interest Payments / EXGS	10.5	11.4	11.3	10.4			

GDP = gross domestic product; o/w = of which.
[a] Since FY1998, including domestic securities owned by nonresidents.