



## INDONESIA: ECONOMIC AND FINANCIAL HIGHLIGHTS NOVEMBER-DECEMBER 2007

### Summary:

- Indonesia's December inflation came in lower on a year-on-year (YoY) basis as consumer demand eased after the Muslim festive season.
- Bank Indonesia (BI) cut its interest rate by 25 bps to 8% at its December board meeting after keeping it steady for four months ending in November.
- Indonesia's GDP expanded a stronger than expected 6.5% YoY during the third quarter of 2007 on robust domestic demand and a higher investment rate.
- The Government of Indonesia (GOI) and market observers assume an overall positive growth picture in 2008, despite high global crude oil prices, and economic sluggishness following the U.S. subprime mortgage crisis.
- The GOI raised a total of Rp 6.6 trillion (\$700 million) from its fourth quarter bond auctions (October-December), concluding its 2007 budget target.
- The GOI bought back Rp 1.2 trillion (\$129 million) worth of bonds maturing 2008-2012 on a December 13 auction.
- BI and the Ministry of Finance (MOF) on December 27, 2007 signed a MOU launching an electronic banking system to support government budget management.
- Banks reported strong earnings for 3Q 2007.
- On December 27, 2007 Malaysia's investment arm Khazanah announced the merger of its two Indonesian banks, Lippo and Niaga to comply with BI's single presence policy.
- Newly merged Indonesia Stock Exchange (combined from the Jakarta and Surabaya Stock Exchanges) commenced trading on December 13.
- Indonesia's sole state-owned toll road operator raised \$380 million from an IPO.
- The Agency for the Rehabilitation and Reconstruction of Aceh and Nias (BRR) handed over the 100,000th house constructed after the December 2004 tsunami disaster.
- This cable uses and exchange rate of 9,419 per dollar.

### Easing Inflation from Holiday Season

The Central Bureau of Statistics (BPS) recorded 1.1% inflation in December, bringing the year-on-year (YoY) inflation rate to 6.6%. The December YoY inflation rate was slightly lower than the 6.7% recorded in November. The slowdown in price increases was attributed mainly to lower prices for foodstuffs. It was the third consecutive month that

headline inflation slowed from the 2007 peak reached in September. Core inflation went up by 0.68% month-on-month (MoM), and 6.29% YoY in December, compared to November's 0.43% and 6.25% respectively.

### CPI Components

Components	November		December	
	MoM	YoY	MoM	YoY
Food stuff	0.04	11.96	2.47	11.26
Food, beverages, tobacco, cigarettes	0.43	6.63	0.91	6.41
Housing, water, electricity, oil/gas	0.12	4.99	0.63	4.88
Clothing	1.66	7.50	0.99	8.42
Health	0.26	4.98	0.41	4.31
Education, recreation, and sport	0.11	8.77	0.12	8.83
Transportation, communication, financial services	-0.27	1.13	0.22	1.25
<b>TOTAL</b>	<b>0.18</b>	<b>6.71</b>	<b>1.10</b>	<b>6.59</b>
<b>Core Inflation *</b>	<b>0.43</b>	<b>6.25</b>	<b>0.68</b>	<b>6.29</b>

Source: Central Bureau of Statistics (BPS)

\* Core inflation is a measure of inflation which excludes certain items that face volatile price movements i.e. energy, food products.

### Interest Rate Cut to 8%

Bank Indonesia (BI) trimmed its benchmark interest rate by 25 basis points to 8.0% at its December 6, 2007 Board meeting, delivering its 14th cut since 2006 following lower-than-expected inflation on November. BI had kept its benchmark interest rate steady the previous four months at 8.25% due to concerns about the impact of unprecedented global crude oil prices.

### Indonesia Recorded Q3 Growth at 6.5%

On November 15, 2007 the Central Statistics Bureau (BPS) reported that the economy grew a faster-than-expected 6.5% YoY in 3Q 2007, on track for its fastest growth in more than a decade in 2007, mainly due to strong commodity exports and low interest rates. Compared to the second quarter, the economy expanded by 3.9% to Rp 2,901.3 trillion (\$308 billion), with a pick-up in fixed investment during the three months to September. Exports and investment rose by 7.8% and 8.8% YoY respectively in the third quarter, topping overall growth, but consumer spending also showed a healthy 5.3% rise, largely driven by a sharp fall in borrowing costs. Transport and telecommunications led among industrial sectors with growth of almost 12.5% YoY in the third quarter. "The agriculture sector contributed the largest portion to economic growth in the third quarter," said Rusman Heriawan, chairman of BPS. Heriawan said the sector grew 10.2% from the previous quarter and 8.9% YoY.

In November 2007, the MOF stated that the GOI hoped to accelerate budget spending in the fourth quarter 2007 to meet its budget target of a 1.5% surplus over GDP – pushing

funds into the economy in the final quarter to further boost economic activity. The GOI posted a budget surplus of Rp 17.6 trillion (\$1.9 billion) in the first 10 months of 2007. As of October, the government had spent Rp 506.6 trillion (\$53.8 billion) against targeted full-year spending of Rp 752.4 trillion (\$79.9 billion), while revenue stood at Rp 524.3 trillion (\$55.7 billion) compared to a full-year target of Rp 694.1 trillion (\$73.7 billion). The MOF estimated full-year growth at around 6.2-6.3%, the country's fastest economic growth rate in 11 years. The economy expanded 5.5% in 2006. The MOF also forecast the rupiah would average 9,170 per dollar in the fourth quarter and 9,125 per dollar for the full year. The Investment Coordinating Board (BKPM) announced on December 19, 2007 that direct investment hit a 40-year record high of Rp 125.94 trillion (\$13.4 billion) in the first nine months of 2007, represented a 169.02% rise compared to 2006.

### **Positive Forecasts for 2008**

The World Bank remained strongly upbeat in its projection for Indonesia's 2008 growth, in line with other East Asian economies. It expects Indonesia's economy to grow steadily at least through to the end of 2008 at 6.4%, following the estimated 6.3% in 2007. The economy could grow by as much as 8% if the government managed to attract more foreign investment to improve infrastructure, World Bank economist William Wallace told reporters. The bank's East Asia and Pacific lead economist Milan Brahmbhatt said that Indonesia would be able to weather short-term global volatility arising out of the US sub-prime mortgage crisis and the renewed surge in oil prices through increased domestic consumption and investment, which would continue to sustain growth.

In a November 21, 2007 interview with Dow Jones, Coordinating Minister for the Economy Boediono stated that the growth target range of 6.5% and 7% in 2008 is still achievable despite signs of a global slowdown, adding that growth would be driven by exports and domestic expansion. He underlined the need for more spending on infrastructure in order to maintain competitiveness. In an interview with Bloomberg, he said that "From the supply side, it is key to keeping inflation under control. I think the main issue here is how to beef up our capacity to prepare good projects."

Finance Minister Sri Mulyani is optimistic that Indonesia could outperform its own projection for growth in 2008. "We are aiming for higher than 6.8%," she said in an interview with Bloomberg, "India and China will be quite strong in actually pulling growth in the region."

"But we must stay alert about a possible rise in inflation and a decline in people's purchasing power in 2008," she added. Slower global economic activity will also impact the economy, she said.

Bank Indonesia is also positive about 2008 growth. BI predicted that the balance of payments surplus would rise 15% to \$15.6 billion, led by foreign direct investment. According to Agence France-Presse, BI stated that the balance of payments surplus in 2007 is estimated at \$13.6 billion, with the surplus reaching \$1.1 billion in the third quarter. BI estimates that the current account surplus will reach \$9.3 billion in 2008,

down from the \$10.9 billion it estimated for 2007, due to slower growth in non-oil-and-gas exports as global demand slows, rather than faster import growth. The capital account surplus is seen rising to \$6.3 billion from \$5.6 billion in 2007. BI expects the investment climate to improve further so that it will also boost capital inflows, especially foreign direct investment. In line with the bigger balance of payments surplus, BI is expecting foreign exchange reserves to rise to \$72.9 billion at the end of 2008 from the \$57.3 billion estimated for the end of 2007.

The International Monetary Fund (IMF), on the other hand, forecasts a slower growth rate in 2008, at 6.1%, compared to 6.2% estimated in 2007. According to its regional economic projection for the Asia Pacific region, Indonesia will be affected by tightened policies in several of the region's countries and by the slowing down of global demand in 2008. However, the IMF expects Indonesia to achieve positive growth in terms of investment due to an improving investment climate.

### **October to December Long-Term Bond Auctions**

The GOI raised Rp 1 trillion (\$0.1 billion) from bond auctions on October 30, 2007. It sold Rp 900 billion (\$95.6 million) of 21-year bonds at a 10.15% yield and Rp 100 billion (\$10.6 million) worth of 15-year paper at an average yield of 9.45%. On November 20, the GOI raised another Rp 1.5 trillion (\$159.3 million) from auctioning five-year zero coupon debt priced to yield 9.869%, slightly below target of Rp 2 trillion (\$212.3 million). Remarks from BI Deputy Governor Hartadi Sarwono the previous week that there was still room to cut interest rates later in 2007 failed to significantly boost demand for the bonds in the auction. The bonds rank among the highest-yielding government debt in Asia.

At its last 2007 bond auction on December 4, the GOI raised Rp 4.1 trillion (\$435.3 million) from issuing eight-year bonds priced to yield 9.63%, double its target of Rp 2 trillion (\$212.3 million), due to strong demand from investors. Ministry of Finance Debt Director Bhimantara Widjajala noted, "We have raised sufficient funds through bonds in 2007 to meet the budget." The 2007 budget targets Rp 58.5 trillion (\$6.2 billion) in bond issues.

### **GOI Debt Buyback**

The Ministry of Finance bought back Rp 1.203 trillion (\$127.7 million) worth of government bonds maturing between 2008 and 2012 via an auction on December 13, 2007. The Ministry of Finance regularly cuts government-borrowing costs and stabilizes debt costs by buying back debt when bond prices fall. "The market response was good. Buybacks can improve investor confidence by maintain liquidity in the market while stabilizing bond prices," noted Rahmat Waluyanto, the Ministry's Director General of Debt Management.

## **Central Bank Launches E-Banking to Support State Budget Management**

On December 27, BI's Senior Deputy Governor Miranda Goeltom and Minister of Finance Sri Mulyani, witnessed the signing of Memorandum of Understanding (MOU) and the initial launch of BI Government Electronic Banking (BIG-eB). The MOU was signed by BI's Deputy Governor Budi Rochadi and MOF's DG of Treasury Herry Purnomo. "The operation of BIG-eB system is an implementation of Law No. 1 of 2004 regarding State Treasury, also an enhancement of fiscal and monetary authority coordination, through the service provided by Bank Indonesia to support government needs in improving the monitoring and management of its Budget", stated Goeltom in her speech.

The Treasury Law describes the Government Account as managed by the Minister of Finance, and maintained in Bank Indonesia. The MOF will be able to obtain online and real time financial information of the Government Account in BI, and to accelerate reporting as well as transaction settlement process. In the first phase, BIG-eB will make available the information module of all Government accounts (only in rupiah currency) maintained in the Head Office and in local offices of Bank Indonesia. Phase II will implement a rupiah transaction module that can be settled through overbooking, such as Treasury Single Account (TSA). Phase III is a foreign exchange information and transaction module implementation of all Government Accounts maintained in the Head Office or at the local offices of Bank Indonesia. Phase IV will integrate the BIG-eB system with the other systems related to the budget management in the MOF.

## **Banks Report Strong Third Quarter Results**

Companies across the range of sectors, including banking, turned in strong 3Q 2007 results by the end of the reporting period on October 31. Bank Mandiri led advances in the banking sector, posting an almost threefold gain in third-quarter profit as loan demand increased and as it set aside less money for bad debts. Bank Rakyat Indonesia (BRI) reported a 17% increase in profit for the first nine months of 2007, while Bank Danamon improved its profit performance by 22% over the same period.

## **Khazanah Plans to Merge Its Two Indonesian Banks**

On December 27, 2007 Malaysian state investment arm Khazanah Nasional Bhd, announced its plan to merge Bank Lippo and Bank Niaga, in line with BI's "single presence" policy. This move would create a bank with combined assets of around Rp 85.6 trillion (\$9.1 billion), making it Indonesia's sixth-biggest lender. According to a statement issued by Lippo, the merger is still subject to regulatory approvals. Khazanah currently owns a 93% stake in Lippo through Santubong Investment BV and Greatville Pte Ltd and 64% share in Niaga through Bumiputra-Commerce Holdings Bhd.

### **Stock Exchanges Merge to Form Indonesia Stock Exchange (BEI)**

The Indonesia Stock Exchange (BEI), a merger of the Jakarta Stock Exchange (JSX) and the Surabaya Stock Exchange (SSX), commenced its first day of trading on December 3, 2007. The merged exchanges, legally effective on November 30, jointly host trading in approximately Rp 2,400 trillion (\$256.8 billion) worth of stocks and bonds issued by 379 companies. Before the merger, 353 companies were listed on the BEJ and 26 on the BES. Capital Markets Supervisory Agency (BAPEPAM) Chairman Fuad Rahmany believes that the merger of the JSX and SSX will set the stage for development of deeper derivatives markets. Previously the SSX, which specialized in bond trading, wanted to explore derivatives (futures, options, real-estate investment trusts) but the underlying asset was often traded on the larger, more liquid JSX. As soon as the merged entity is stable, one bond market official predicted that the MOF and BAPPEPAM would roll out bond futures early 2008. The SSX was already in the advanced stages of developing a financial futures contract for government bonds.

### **State-Owned Toll Road Operator IPO Raises \$380M**

On October 26, 2007, the GOI raised Rp 3.47 trillion (\$368.4 million) from the sale of 30% of PT Jasa Marga, the country's leading toll road operator. The Jasa Marga offer, with a price range of Rp 1,400 and Rp 1,800, was more than four times over-subscribed, fixing the price at the top of the range at Rp 1,700. About 40% of the institutional tranche went to international investors, while the remaining 60% was allocated to domestic investors. The final price values the toll road operator at about 22.5 times its projected 2008 earnings. Analysts believe that Indonesia is picking up demand from investors who want to put their money into something other than China and the huge amount of money currently pouring in from the US. The deal is the second sale of stock in a state-owned company in 2007, after the government's secondary offering in PT Bank Negara Indonesia (BNI) at the end of July, which cut the government's stake in BNI from 99.1% to about 73% and raised \$774 million.

### **Aceh Reconstruction Agency (BRR) Completes 100,000th Tsunami House**

On December 14, 2007, close to the third anniversary of the Aceh tsunami disaster, the Agency for the Rehabilitation and Reconstruction of Aceh and Nias (BRR) symbolically handed over 138 houses which included the 100,000th new house built for tsunami survivors. The formal ceremony took place in Teunom village, Aceh Jaya district, one of the areas worst hit by the tsunami. "We wanted to give a morale boost to the people here in rebuilding their district," spokesman of the agency Mirza Keumala said, adding that people still faced daily challenges as infrastructure remained poor. Keumala said that reconstruction of a targeted 120,000 houses was expected to be completed by April 2008, and despite the formal ceremony on Friday, 103,000 have now been finished.

Earlier, BRR head Kuntoro Mangkusubroto, launching a report on progress on tsunami recovery programs, said progress had been "very encouraging and better than planned three years ago" with more than 102,000 homes built and another 20,000 due to be

completed by June 2008. Mangkusubroto, a former mining minister, said that the agency was now focused on handing over assets and recovery efforts to the locals, but conceded that problems were emerging. Decent housing remains a massive concern for the local population. The agency, whose mandate ends in April 2009, plans to get 3,000 families still in temporary wooden barracks surrounding the provincial capital Banda Aceh into new homes by 2008. "There will be no more housing projects or housing construction beyond April 2008, except one or two organizations," he warned in November. "We understand there are still problems. We are going to solve these problems." Apart from houses, BRR has also coordinated and completed the reconstruction of about 2,000 km of roads, 800 schools, 600 hospitals and health centers, 17 seaports and 10 airstrips across the province by Nov 2007.

### **Selected Economic, Monetary & Financial Statistics**

	Sep 07	Oct 07	Nov 07	Dec 07
CPI Inflation (YoY)	6.95	6.88	6.71	6.59
CPI Inflation (MoM)	0.80	0.79	0.18	1.10
Rp/USD Exchange rate <sup>1</sup>	9,137	9,103	9,376	9,419
30-day SBI Interest Rate <sup>2</sup>	8.25	8.25	8.25	8.00
Foreign reserves <sup>3</sup>	52.9	51.4	54.9	
JSX Composite Index	2,359	2,643	2,688	2,746
Exports (USD billion)	9.5	10.3	9.8	
% Change (YoY)	7.6	17.6	10.0	
Import (USD billion)	6.8	6.3	7.5	
% Change (YoY)	17.4	19.3	20.4	
Trade Balance <sup>5</sup>	2.7	4.0	2.3	

*Source: Bank Indonesia, BPS*

*(1) Rp/USD, end of period*

*(2) End of period*

*(3) USD billions, end of period*

*(4) Jakarta Stock Exchange average daily transaction volume, in billions of shares*

*(5) USD billions*

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