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IMF Executive Board Concludes 2014 Article IV Consultation with Indonesia

On March 9, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Indonesia.

Sound macroeconomic management and exchange rate flexibility have bolstered policy credibility and external resiliency in Indonesia over the past 18 months. In the face of Fed tapering and headwinds posed by slumping commodity prices, policy and reserve buffers have been strengthened through a clearer policy framework and better policy coordination. Markets have responded favorably, as evidenced by large portfolio inflows in 2014 and so far in 2015. Overall, the banking system remains sound and well capitalized, while the corporate sector has been affected by a cyclical slowdown. Key risks, which emanate mainly from external sources, are moderately to the downside, requiring continued vigilance by policymakers.

Notwithstanding commodity sector developments and global risk factors, the near-term outlook is broadly positive. Led by a pickup in public investment, growth should reach around 5¼ percent this year. Inflation is expected to return to within BI's target band by year end, given the current monetary stance and fuel price outlook. The current account deficit should also narrow slightly, with a lower oil import bill offsetting pressures arising from non-oil commodity exports, while foreign reserves are expected to rise moderately.

Decisive fiscal policy actions taken since late 2014 on fuel subsidy reforms have opened space in the budget to support government plans to increase social and infrastructure spending, but lower oil and gas revenues may constrain available resources in the near term. Monetary policy continues to provide a strong anchor to inflation expectations and facilitate external adjustment, with the latter also aided by flexibility in the exchange rate and bond yields. Financial sector

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

policies have been aimed at deepening market activity, enhancing macro and micro prudential oversight, and increasing corporate sector resilience.

Looking ahead, the main challenge for Indonesia is to chart a course to higher, more inclusive growth, while preserving macro-financial stability and further strengthening the external position. Moderate fiscal consolidation would help improve funding conditions and facilitate external adjustment. It should be underpinned by a broad tax revenue strategy and supported by prudent borrowing, with a view to generating ample resources for growth-critical spending and maintaining debt sustainability. The current monetary stance appears appropriate until inflation and external pressures firmly ease. Financial stability is expected to be preserved through prudential measures backed by strengthened frameworks for risk assessment and protocols on crisis management. Structural policies should address longstanding supply bottlenecks, deepen financial markets, and create a more supportive trade and investment climate in order to expand the export base, stimulate job creation, and raise potential growth.

Executive Board Assessment[2]

Executive Directors commended the authorities for their sound macroeconomic management, which has strengthened policy and reserve buffers. Directors, however, noted that the economy faces downside risks, particularly those arising from external sources. In this context, Directors agreed that policy priorities and structural reforms should continue to focus on consolidating recent stability gains, containing vulnerabilities, and boosting growth potential.

Directors encouraged the authorities to continue to maintain a prudent fiscal stance to enhance resilience to shocks. They welcomed the decisive measures taken to eliminate the bulk of fuel subsidies. Directors supported the use of the expanded fiscal space to increase growth-critical social and capital spending, noting that bridging infrastructure needs would enhance Indonesia's longer-term growth prospects. To achieve this goal, they underscored the importance of raising nonoil tax revenues, including by strengthening tax administration. Directors also encouraged further efforts to phase out the remaining subsidies, while protecting the most vulnerable households. In addition, they recommended close monitoring of risks related to state-owned enterprises and public-private partnerships.

Directors considered the current monetary policy stance to be broadly appropriate to anchor inflation expectations and support external adjustment. They noted that continued exchange rate and bond yield flexibility would help mitigate the impact of external shocks. Directors supported efforts to deepen money markets to improve liquidity management and strengthen monetary transmission.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors observed that Indonesia's financial system remains sound. With the system having transitioned to a new regulatory and supervisory architecture, they stressed the importance of further progress to enhance macro- and microprudential oversight, strengthen the capacity for risk assessment, and expeditiously put in place an effective crisis management framework, including by enacting the Financial System Safety Net Law. A number of Directors advised removal of interest caps on deposits. They supported efforts to strengthen corporate sector resilience, including by better managing rising external debt. Noting the progress made in the AML/CFT framework, Directors encouraged further efforts to address the remaining deficiencies.

Directors welcomed the authorities' emphasis on supply-side reforms to alleviate infrastructure bottlenecks, deepen financial markets, and streamline investment approvals in order to bolster employment and growth prospects. Going forward, they highlighted the importance of improving the trade and investment regime, addressing labor market issues, including by aligning wage settlements with productivity increases, and fostering human resource development, focusing particularly on investment in education. Efforts to broaden the export base will also be important.

Indonesia: Selected Economic Indicators, 2010–16

	2010	2011	2012	2013	2014	2015	2016
					Est.	Proj.	
Real GDP (percent change)	6.2	6.5	6.3	5.7	5.1	5.2	5.5
Domestic demand	5.4	6.0	7.9	5.2	5.1	4.8	5.1
Net exports 1/	0.9	1.5	-1.4	2.1	0.3	0.9	0.9
Saving and investment (in percent of GDP)							
Gross investment 2/	32.3	32.9	34.7	33.6	33.5	33.5	33.9
Gross national saving	33.0	33.1	31.9	30.3	30.5	30.7	31.2
Prices (12-month percent change)							
Consumer prices (end period)	7.0	3.8	3.7	8.1	8.4	4.5	4.8
Consumer prices (period average)	5.1	5.3	4.0	6.4	6.4	6.8	5.8
Public finances (in percent of GDP)							
Central government revenue	15.4	16.3	16.3	15.8	15.2	13.5	14.1
Central government expenditure	16.2	17.5	18.1	18.2	17.5	15.9	16.4
Of which: Energy subsidies	2.2	3.4	3.7	3.4	3.4	1.0	0.9
Central government balance	-0.7	-1.1	-1.9	-2.3	-2.3	-2.4	-2.3
Primary balance	0.6	0.1	-0.6	-1.1	-0.9	-1.1	-0.8
Central government debt	26.1	24.4	24.0	26.1	26.1	26.8	26.8
Money and credit (12-month percent change; end of period) 3/							
Rupiah M2	16.5	17.4	14.4	9.4	13.5	13.5	...
Base money	28.9	18.3	14.9	16.7	11.6	11.9	...
Private sector credit	19.6	25.4	22.3	20.0	11.8	12.5	...
One-month interbank rate (period average)	6.4	6.2	4.4	5.8	7.5	...	...
Balance of payments (in billions of U.S. dollars, unless otherwise indicated) 3/							
Current account balance	5.1	1.7	-24.4	-29.1	-25.7	-24.3	-25.5
In percent of GDP	0.7	0.2	-2.8	-3.3	-3.0	-2.8	-2.7
Trade balance	31.0	33.8	8.7	5.8	7.8	11.3	11.7
Of which: Oil and gas (net)	3.2	-0.7	-5.2	-9.7	-10.4	-7.4	-7.9
Inward direct investment	13.8	19.2	19.1	18.8	21.5	22.9	24.5
Overall balance	30.3	11.9	0.2	-7.3	13.6	8.0	5.6
Terms of trade, percent change (excluding oil)	10.4	7.3	-2.9	-3.5	-3.3	-4.1	1.4
Gross reserves							
In billions of U.S. dollars (end period)	96.2	110.1	112.8	99.4	111.9	119.9	125.5
In months of prospective imports of goods and services	6.1	6.2	6.4	6.0	7.2	7.2	6.9
As a percent of short-term debt 4/	224	236	206	175	173	178	179
Total external debt 3/ 5/							
In billions of U.S. dollars	202.4	225.4	252.4	265.6	297.5	316.7	333.4
In percent of GDP	28.5	26.7	28.7	30.5	35.0	36.2	35.6
Exchange rate							
Rupiah per U.S. dollar (period average)	9,088	8,774	9,375	10,414	11,862	...	...
Rupiah per U.S. dollar (end of period)	8,979	9,075	9,638	12,171	12,435	...	...
Memorandum items:							
Jakarta Stock Exchange (12-month percentage change, composite index)	46.1	3.2	12.9	-1.0	22.3	...	...
Oil production (thousands of barrels (bbls) per day)	945	907	860	830	794	825	840
Nominal GDP (in trillions of rupiah)	6,447	7,419	8,231	9,087	10,095	11,309	12,621

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ Contribution to GDP growth (percentage points).
2/ Includes changes in stocks.
3/ For 2014, figures are projections.
4/ Short-term debt on a remaining maturity basis.
5/ Public and private external debt.