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WORLD BANK GROUP
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
MULTILATERAL INVESTMENT GUARANTEE AGENCY

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Statement by the Hon. **BURHANUDDIN ABDULLAH**,
Governor of the Fund for **INDONESIA**,
at the Joint Annual Discussion

Statement by the Hon. Burhanuddin Abdullah,
Governor of the Fund for Indonesia,
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Mr Chairman, Ladies and Gentlemen,

In this opportunity, let me share with you some of my thought regarding our current situation. I begin with recent economic development and a highlight of our new policy program and conclude my remarks by presenting our economic outlook.

I welcome the increasing signs of improving development in our global economic scene. I believe the encouraging prospect for a steady and strengthening global recovery will provide a strong support for better growth and reforms in developing countries, including Indonesia. In line with this latest global economic development, Indonesian economy has also witnessed encouraging progress.

Since the last year when we reported in this forum, our economy has continued to progress favorably. This is reflected in the improvement of some economic indicators, including modest GDP growth at a range of 3.5 to 4%, easing inflationary pressures, and significant strengthening and stability of rupiah exchange rate. The economy has shown remarkable resilience in the face of external and domestic shocks in recent years including the Bali bombing in 2002 and more recently, the Marriot bombing.

Following a strong performance in 2002, with GDP grew by 3.7%, the Indonesian economy recorded a growth rate of 3.6% in the first half of 2003. We expect to reach our GDP growth target of 4% for the year 2003. In the past several months, we have been quite successful in curbing inflationary pressures. As measured year-over-year, the inflation rate at the end of August fell to 6.38%. This performance was largely due to the appreciation of the rupiah and slow growth in base money, in addition to favorable supply factors. For the year of 2003 as a whole, we are projecting an inflation rate of around 6%, lower than our target of 9%.

The strengthened rupiah has a positive impact in capping inflation. During the second quarter, the rupiah appreciated over 4% from the previous quarter. After falling in July 2003, currently the rupiah has traded in a narrow band around Rp8,500. The appreciation of the rupiah during the first half of 2003 was associated with a positive sentiment towards the country, illustrated by higher dollar inflows, related to privatization, the sale of IBRA assets, and the upgrade of Indonesia credit rating.

The drop in inflationary expectations and the appreciation of the rupiah has allowed Bank Indonesia to pursue a monetary policy that is designed to facilitate an accelerated recovery process by guiding interest rates lower. The 1 month SBI rate declined 402 basis points from 12.93% at the end of 2002 to 8.91% at end of August. Throughout the year, the growth of base money has remained within target. This gives us confidence that we will be maintaining the growth in money so that there is sufficient liquidity to satisfy the needs of the real economy, without risking a run-up in inflation.

Supported by improved macro-monetary conditions, banking sector shows stronger condition. This was reflected in a stronger capital structure, improved NPLs, stronger profitability and recovery in bank intermediation. All banks are now in compliance with the mandatory capital adequacy ratio of 8%. This has allowed the banking sector's net income to grow as new credits extended have increased in the first half of the year and non-performing loans continue to remain under control with net NPLs reaching only 1.02% in June.

As regards fiscal issues, the process of fiscal consolidation advanced with the passage of the revised budget for 2003, which targets a lowering of the deficit to 1.8% of gross domestic product and an increase in the primary surplus to 2.5% of GDP. We are well on our way to meeting this goal, among others, by gradual elimination of fuel subsidies. For the first six months of the year, the realized deficit reached only Rp6.2 trillion compared with the full year budget deficit of Rp34.4 trillion. In order to achieve the Government's goal of a balanced budget by 2005, the Government has undertaken an extensive and comprehensive effort to overhaul the tax and customs administration systems with technical assistance from the IMF. On of the significant achievements was the establishment of a Large Taxpayer's Office. In customs, we are extending green lane privileges to qualified taxpayers and improving customs valuation procedures. Indonesia has a relatively low tax to GDP ratio, which means that the Government should be able to increase tax revenues significantly, not through major changes in underlying rates, but through the improved monitoring and collection procedures. Strict fiscal controls combined with the improved performance of IBRA have allowed the Government to begin the process of reducing the debt burden.

Despite all these encouraging development in the area of monetary and financial stability as well as fiscal issues, challenges or even problem remains. These challenges include maintaining consistency and descipline of our economic management to support sustainable recovery in light of the upcoming "graduation" from the IMF program.

To address these problems, Indonesian authorities have been working closely in developing our own economic program to continue the reform path stated in the IMF Letter of Intent. With political stability and improving economic and financial performance, the political mood of the majority of people in Indonesia supports the idea of "graduating" from the formal IMF program this year. With the support from international communities, we are confident that we can and we will be able to obediently and consistently implement the program. The new policy programs in 2004 onwards will be based on three main pillars.

The first pillar is maintaining macroeconomic stability. To materialize this pillar, for monetary policy, we are in the process of preparing the new framework of monetary policy, i.e., inflation targeting framework. This framework provides clarity in our objective and consistency in our monetary policy to pursue price stability, thereby gradually improve credibility. For fiscal policy, the government carries on its tax and custom reforms as well as its budget reform to simplify the procedure and improving competitiveness without jeopardizing our fiscal position.

The second pillar comprises of continuing efforts to restructure and reform the financial sector. In banking sector, in the effort to maintain financial system stability and improve governance, Bank Indonesia is currently in the process of preparing Indonesia's Banking Architecture (API) that can be used as a comprehensive and forward-looking platform for banking policy. We continue to improve banking supervision and increase the role of the capital market in financial system.

The third pillar of the post IMF policy program deals with our efforts to enhance our investment climate so that we may achieve a level of growth sufficient to reduce unemployment and poverty. Key measures for this pillar include a new investment law, simplified registration procedures, more participation in infrastructure and numerous other measures.

Ladies and Gentlemen,

Before closing my remarks, let me figure out the outlook of our economy. Looking forward to 2004, we will continue to strengthen our macroeconomic fundamentals to be the basis for stronger growth in 2004 onward. While monetary policy will remain prudent, as both the inflation rate and the risk premium decline, fiscal policy will stay focused on achieving sustainability. This will require further steps to increase revenue collection and improve access to financing. But as the recovery continues we can begin to look forward to strategic investments to improve the welfare of the people and support the development of the economy.

Good macroeconomic management, however, is not enough to sustain high rates of economic growth. High growth requires structural reforms to make the economy more efficient. Such reform programs that the Government is undertaking include the strengthening of legal infrastructure, improving governance and increasing transparency in both public and pri-ate sectors. The purpose of the program that we have developed is not reform for reform sake, but to restore investor's confidence in Indonesia.

We fully expect our macroeconomic policy, coupled with the consistent implementation of our structural reform, will allow economic growth to reach 4% this year and will establish the base of real growth of 6% over the medium-term.

Finally, I would like to thank the IMF, World Bank and international community at large for their invaluable support to us in our effort to recover from the crisis, as well as in our effort to reform. We believe that our favorable economic developments will enhance market confidence in Indonesia, confidence that we expect to be sustained in the future years.

Thank you.