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IMF Executive Board Concludes 2015 Article IV Consultation with Indonesia

On February 24, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Indonesia.

Over the past few years, the significant strengthening of the policy framework in Indonesia has bolstered macroeconomic resilience. This was demonstrated by sound monetary management and a prudent fiscal stance, underpinned by historic fuel subsidy reforms in 2015. These actions reinforced macroeconomic stability and supported growth. In effect, Indonesia safely navigated a difficult external environment in 2015, characterized by the fall of commodity prices, shifts in global financial conditions, and slower growth of trading partners. Medium-term prospects are favorable, supported by an inclusive growth-enhancing policy agenda that also places emphasis on stability.

Overall, macroeconomic performance in 2015 has been positive. Economic growth is forecast to see a moderate acceleration to around 5 percent in 2016; investment activity would lead the recovery, in particular, public sector spending. However, weak commodity prices and slower demand from trading partners present headwinds to growth. Inflation has fallen sharply at end-2015, and is expected to remain within the inflation target band (3–5 percent) in 2016. The external current account deficit narrowed significantly in 2015 to around 2 percent of GDP on lower imports, and is projected to increase moderately in 2016 due to a pickup in domestic demand. The fiscal deficit in 2015 widened but remained below the 3 percent of GDP statutory limit for the general government.

Risks to the outlook are tilted to the downside, mainly from external factors including more volatile global financial conditions, a deeper-than-expected slowdown in emerging market

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.

trading partners, and further declines in commodity prices, requiring continued vigilance by policymakers.

The authorities' fiscal policy strategy aims to create fiscal space through improved revenue mobilization and reform of general subsidies in order to increase spending on infrastructure and targeted social programs. Early successes include the large reduction in fuel subsidies and the expansion of conditional cash transfers and public investment. Nonetheless, important challenges remain with revenue mobilization from the effects of lower commodity prices and a related contraction of imports.

The relatively tight stance of monetary policy in 2015, combined with exchange rate and bond yield flexibility, helped the economy adjust to external pressures, which have eased in early 2016. The authorities appropriately allowed the exchange rate to reflect market forces, with judicious foreign currency interventions to ensure the orderly functioning of markets. Allowing government bond yields to be market determined has facilitated government financing despite volatility in external financial conditions.

Looking ahead, the main policy challenge for Indonesia is to chart a course to higher, more inclusive growth in the medium term, while navigating the more volatile global environment by preserving macro-financial stability and further strengthening the external position.

Strengthening the fiscal framework through an enhanced revenue strategy would help, with policy framed in a medium-term plan that provides guidance to government programs. Higher public investment should be combined with sound public financial management, governance reform of state-owned enterprises, and monitoring of potential fiscal risks. The gradual unwinding of the tight monetary policy stance is appropriate as long as inflation remains contained and financial markets continue to be calm. Expeditious approval of the draft Financial System Safety Net law is a top priority to strengthen the institutional framework for financial sector stability. The structural reform strategy is well-focused on improving competitiveness to accelerate economic growth and diversify the economy. A series of policy packages issued since August 2015 signal a renewed policy strategy to improve the business climate and reduce the cost of doing business, thus catalyzing higher private investment and raising potential growth prospects for Indonesia.

Executive Board Assessment²

Executive Directors commended the authorities' sound macroeconomic management and commitment to reform, which has allowed the Indonesian economy to weather the downturn in commodity prices and the challenging external environment. While the outlook is positive,

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>.

downside risks remain, and Directors encouraged the authorities to continue to implement prudent policies to safeguard resilience and to sustain structural reform efforts.

Directors considered the fiscal strategy to be appropriate. They welcomed the authorities' commitment to adjust the 2016 budget in light of a lower revenue outlook, and looked forward to continued adherence to the fiscal rule. Directors commended the decisive energy subsidy reforms in 2015, including plans to better target electricity subsidies, and the use of the resulting fiscal space to increase growth-critical social and capital spending. At the same time, the underperformance of revenues has underscored the need to improve revenue mobilization by enhancing tax policy and revenue administration, in the context of a medium-term fiscal framework, to finance the large infrastructure needs and other priorities. Directors also stressed the importance of sound public investment planning and management, and highlighted the role that carefully designed PPPs could play in helping to address infrastructure needs.

Directors noted that the tight monetary policy in 2015 has helped to anchor inflation. While the recent easing is appropriate, they agreed that it should be gradual and cautious to safeguard financial stability, keep inflation within the target band, and support external adjustment. Directors supported continued exchange rate flexibility and market-determined bond yields. They welcomed efforts to deepen money markets to improve liquidity management, strengthen monetary policy transmission, and help manage external financial volatility.

Directors took positive note that Indonesia's financial system is sound, but called for close monitoring of pockets of vulnerability. They called for expeditious enactment of the Financial System Safety Net law to clarify the frameworks for emergency liquidity assistance and bank resolution and align the mandates of financial sector agencies with the new structure. Directors encouraged effective implementation of the framework for monitoring risks in the corporate sector to address vulnerabilities stemming from foreign currency exposures and refinancing risks.

Directors welcomed the new direction of structural reforms and investment liberalization and called for continued efforts to bolster employment, diversify the economy, and raise growth potential. They emphasized the need to press ahead with reforms to revamp the business climate, streamline regulations, increase international trade and investment integration, deepen financial markets, and improve labor market flexibility.

Indonesia: Selected Economic Indicators

	2011	2012	2013	2014 Est.	2015 Proj.	2016 Proj.
Real GDP (percent change)	6.2	6.0	5.6	5.0	4.7	4.9
Domestic demand	6.0	7.3	5.1	4.7	4.0	5.1
Of which:						
Private consumption 1/	5.1	5.5	5.4	5.3	4.8	4.9
Government consumption	5.5	4.5	6.9	2.0	4.0	5.0
Gross fixed investment	8.9	9.1	5.3	4.1	4.4	5.7
Change in stocks 2/	-0.2	0.8	-0.3	0.2	-0.5	0.0
Net exports 2/	0.2	-1.5	0.6	-0.3	0.8	0.0
Saving and investment (in percent of GDP)						
Gross investment 3/	33.0	35.1	34.0	34.7	34.3	34.8
Gross national saving	33.2	32.4	30.9	31.6	32.3	32.3
Prices (12-month percent change)						
Consumer prices (end period)	3.8	3.7	8.1	8.4	3.4	4.5
Consumer prices (period average)	5.3	4.0	6.4	6.4	6.4	4.5
Public finances (in percent of GDP)						
Central government revenue	15.5	15.5	15.1	14.7	13.0	12.1
Central government expenditure	16.5	17.3	17.3	16.9	15.7	15.0
Of which: Energy subsidies	3.3	3.6	3.3	3.2	1.0	0.6
Central government balance	-1.1	-1.8	-2.2	-2.2	-2.8	-2.8
Primary balance	0.1	-0.6	-1.0	-0.9	-1.4	-1.3
Central government debt	23.1	23.0	24.9	24.7	27.5	28.4
Money and credit (12-month percent change; end of period)						
Rupiah M2	17.4	14.4	9.4	13.5	13.5	14.0
Base money	18.3	14.9	16.7	11.6	6.4	11.0
Private Sector Credit	25.4	22.3	20.0	11.8	11.4	12.6
One-month interbank rate (period average)	6.2	4.4	5.8	7.5	7.2	...
Balance of payments (in billions of U.S. dollars, unless otherwise indicated)						
Current account balance	1.7	-24.4	-29.1	-27.5	-16.8	-22.8
In percent of GDP	0.2	-2.7	-3.2	-3.1	-2.0	-2.5
Trade balance	33.8	8.7	5.8	7.0	14.9	10.8
Of which: Oil and gas (net)	-0.7	-5.2	-9.7	-11.8	-7.7	-7.6
Inward direct investment	19.2	19.1	18.8	23.0	18.8	20.4
Overall balance	11.9	0.2	-7.3	15.2	-4.3	2.5
Non-oil and gas exports, volume growth	12.6	4.5	2.5	3.3	-1.5	3.5
Non-oil and gas imports, volume growth	12.2	16.5	-1.2	-0.8	-8.3	9.6
Terms of trade, percent change (excluding oil)	5.3	-0.7	-2.2	-1.8	-8.3	-0.2
Gross reserves						
In billions of U.S. dollars (end period)	110.1	112.8	99.4	111.9	105.9	108.4
In months of prospective imports of goods and services	6.2	6.4	5.9	8.0	7.3	6.8
As a percent of short-term debt 4/	236	206	177	192	177	175
Total external debt 5/						
In billions of U.S. dollars	225.4	252.4	266.1	293.7	314.0	330.7
In percent of GDP	25.2	27.5	29.2	33.1	36.6	36.6
Exchange rate						
Rupiah per U.S. dollar (period average)	8,774	9,375	10,414	11,862	13,389	...
Rupiah per U.S. dollar (end of period)	9,075	9,638	12,171	12,435	13,788	...
Memorandum items:						
Jakarta Stock Exchange (12-month percentage change, composite index)	3.2	12.9	-1.0	22.3	-12.1	...
Oil production (thousands of barrels per day)	907	860	830	794	800	830
Nominal GDP (in trillions of rupiah)	7,832	8,616	9,525	10,543	11,516	12,629

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

1/ Includes NPISH consumption.

2/ Contribution to GDP growth (percentage points).

3/ Includes changes in stocks.

4/ Short-term debt on a remaining maturity basis.

5/ Public and private external debt.