Overseas Development Institute

Global Financial Crisis Discussion Series

Paper 6: Indonesia

Ira S Titiheruw, Hadi Soesastro and Raymond Atje

Centre for Strategic & International Studies

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Ira S Titiheruw, Hadi Soesastro and Raymond Atje

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Overseas Development Institute
111 Westminster Bridge Road
London SE1 7JD

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Acronyms

ADB	Asian Development Bank
AFS	Available for Sale
ASEAN	Association of Southeast Asian Countries
BII	Bank International Indonesia
CAR	Capital Adequacy Ratio
CBS	Central Bureau of Statistics
CE	Consumption Expenditure
DMO	Debt Management Office
EU	European Union
FDI	Foreign Direct Investment
fob	Free on Board
FSSN	Law on Financial System Safety Net
ILO	International Labour Organization
IMF	International Monetary Fund
JV	Joint Venture
L/C	Letter of Credit
LDR	Loan-to-deposit Ratio
MoF	Ministry of Finance
NIM	Net Interest Margin
NOP	Net Open Position
NPL	Non-performing Loan
PIP	Government Investment Centre
RDB	Regional Development Bank
ROA	Return on Assets
SBI	Bank Indonesia Certificate
SNI	Indonesian National Standard
SPP	Single Presence Policy
SUN	Government Security
SUSENAS	National Socioeconomic Survey
UAE	United Arab Emirates
UK	United Kingdom
UN	United Nations
UNDP	UN Development Program
US	United States

Abstract

Up to September 2008, Indonesia's was economy still showing some resilience towards the global financial crisis already underway in the world's most powerful economies. However, during the October-December 2008 period, the country's economy experienced deteriorating economic performance at an unprecedented speed; quarterly economic growth fell from 6.1% to 5.2% on a yearly basis and export growth was at only 1.82%, the slowest since 1986. With downward revision to the country's economic growth in 2009 to 4-4.7% (previously 5% in 2008), the government plans a fiscal stimulus package to maintain private consumption levels to cushion the impact of the global financial crisis, as domestic consumption has contributed a significant share (65%) of Indonesia's gross domestic product (GDP). Policies to keep financial market stability are also being launched, particularly to keep inflationary pressures down and prevent depleted domestic purchasing power. Unemployment and poverty reduction will be affected, but not as severely as in 1997-1998, owing to the existence of favourable factors such as relatively low fuel and commodity prices and a good rainy season so far.

1. Introduction

It was a year ago that people were still discussing the possibility of 'decoupling', owing to the fact that some Asian countries appeared to show very few impacts of the financial crisis already on the way in the US and other developed countries. Indonesia, even until September 2008, was still in a good position – the growth rate was still recorded at 6.1% (year-on-year). Export growth had weakened but import of capital goods was still increasing, suggesting that some investment activities were still taking place. Last quarter growth in 2008 was still predicted to reach 5.7%.

But the last three months of 2008 sent the strongest sense of crisis to the country, as worrying signs were spotted everywhere, from the financial market to the real sector of the Indonesian economy. Economic growth in the last quarter fell short of the previously estimated 5.7%. It was much lower: 5.2% for the fourth quarter of 2008, with export growth dropping to the lowest level since 1986 (1%).

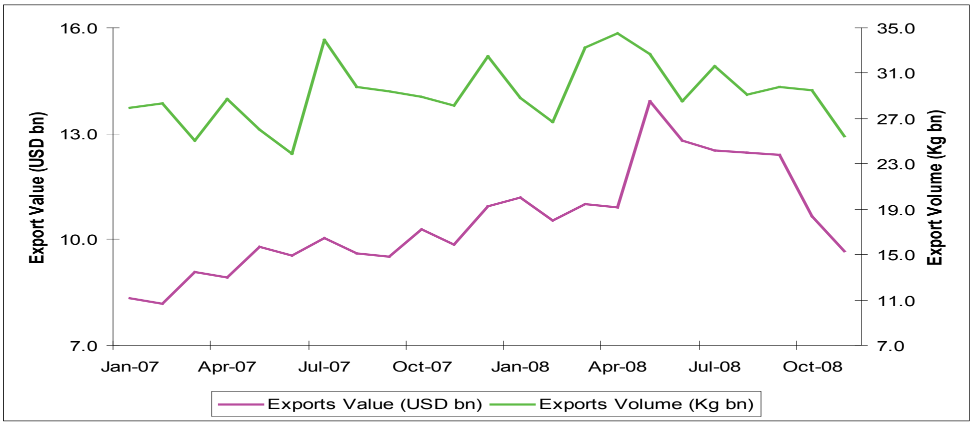
Many believe that the worst is still to come, so some of the data presented here should be considered too early to estimate the overall impact of the global crisis on the Indonesian economy. Following this short introduction, the report is structured as follows: Section 2 will identify components of the shock at national level, such as export performance, financial contagion that will greatly influence capital flows and financial intermediaries and workers' remittances. Section 3 will discuss crisis impacts on growth, employment and poverty. Section 4 will explain government responses, both actual and possible, to ward off current crisis impacts. Section 5 concludes the report.

2. The global financial crisis and shocks at the national level

2.1 Impact on trade

Export performance has continued to decline since the second semester of 2008. There are two reasons for this: first, drops in commodity prices since mid-year; second, weakened external demand after September 2008. Figure 1 shows that both export value and export weight began to fall during the last three months of 2008.

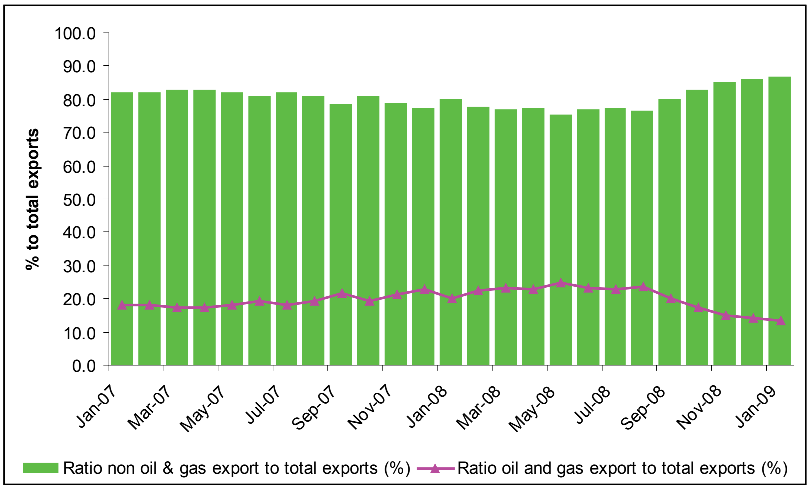
Figure 1: Indonesia's exports, Jan 2007-Nov 2008 (by value and weight)



Source: CEIC Asian database.

For Indonesia, non-oil and gas have always dominated exports. In 2007-2008, the proportion of non-oil and gas exports remained above 80%, except during February-August 2008, owing to high prices for oil. Figure 2 shows the proportions of both oil and gas and non-oil and gas in Indonesia's total exports.

Figure 2: Proportion of oil and gas exports and non-oil and gas exports in total exports, 2007-2008 (%)



Source: CBS (2007-2009).

January 2009's year-on-year export growth dropped 36.08%. For oil and gas exports, the decline was 57.8% on a yearly basis, with the proportion of oil and gas exports in total exports standing at 13.24%. Non-oil and gas exports, which dominated Indonesia's total exports (in January 2009, the share was 86.76%), dropped 30.64% (year-on-year).

For the top 10 export commodities, the biggest year-on-year declines in export value in January 2009 were recorded for commodity groups of tin and articles thereof (HS 80) and animal or vegetable fats and oils (HS 15), which saw 87% and 52.7%, respectively.

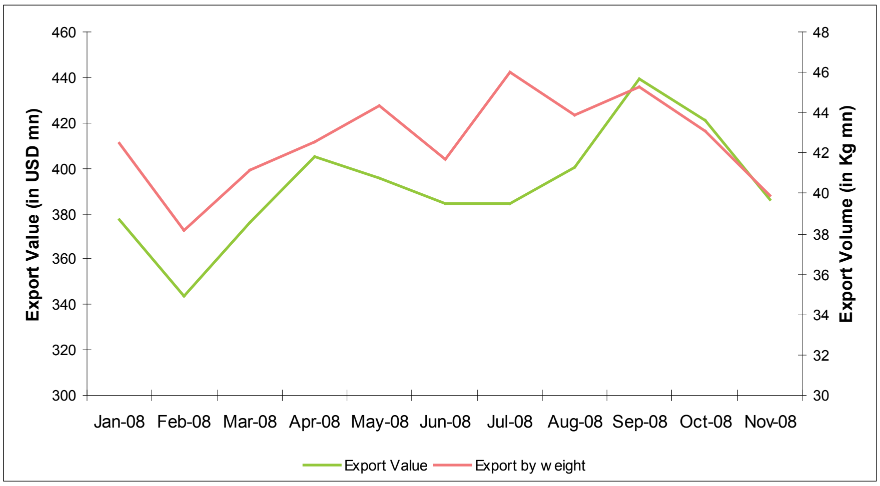
Table 1: Non-oil and gas exports, 2008 and 2009

	fob value (US$m)					
Commodity group (HS)	Jan 2008	Dec 2008	Jan 2009	Jan-Dec 2008	Change of Jan 2009 over Dec 2008 (US$m)	% share in non-oil and gas total, Jan 2009
1. Animal or veg. fats and oils (15)	1619.2	835.5	765.9	15,569.7	-68.6	12.36
2. Mineral fuels, mineral oil products (27)	604.3	944.9	753.0	10,659.9	-191.9	12.13
3. Elect. machinery, sound rec., TV etc. (85)	600.2	621.6	452.9	8108.8	-168.7	7.30
4. Rubber and articles thereof (40)	538.1	340.2	264.0	7616.7	-76.2	4.25
5. Nuclear react., boilers, mech. appli. (84)	384.7	392.9	304.8	5216.5	-88.1	4.91
6. Paper and paperboard, and articles thereof (48)	303.9	261.0	268.1	3734.7	7.1	4.32
7. Copper and articles therefore (74)	204.0	105.5	135.0	2229.1	29.5	2.18
8. Tin and articles thereof (80)	445.5	10.2	57.7	1993.5	47.5	0.93
9. Iron and steel (72)	148.9	68.9	105.9	1689.9	38.0	1.72
10. Natural and cultured pearls, precious/semi precious stones (71)	129.7	97.3	111.2	1072.8	13.9	1.79
Total of 10 commodity groups	4978.5	3678.0	3220.5	57,891.6	-457.5	51.89
Others	3969.2	3770.1	2985.7	49,961.1	-784.4	48.11
Total non-oil and gas exports	8947.7	7448.1	6206.2	107,852.7	-1241.9	100.00

Note: * fob = free on board.
Source: CBS (March 2009).

Exports of electronic products (HS 85) to all destination countries in 2008 showed both weight and value had an increasing trend until September 2008. Then both went down, reflecting weakening external demand. The biggest destination of electronic products exports has been to members of the Association of Southeast Asian Countries (ASEAN) such as Singapore and Malaysia (approximately 40% of total electronic exports). Another major destination country for electronic exports is Japan (11.81%).

Figure 3: Electronic (HS 85) exports, 2008 (by weight and value)



Source: CEIC Asian database.

Falling demand, especially from main destination countries, has clearly taken its toll on Indonesian export performance. ASEAN is Indonesia's biggest trade partner (20.34% of total non-oil and gas export market), followed by the European Union (EU) (16.55%). For individual countries, Japan and the US had the biggest share of the country's export market, accounting for 12.7% and 12.44%, respectively, in January 2009. China has become an important trading partner and had a 7.36% share in Indonesia's export market (see Table 2).

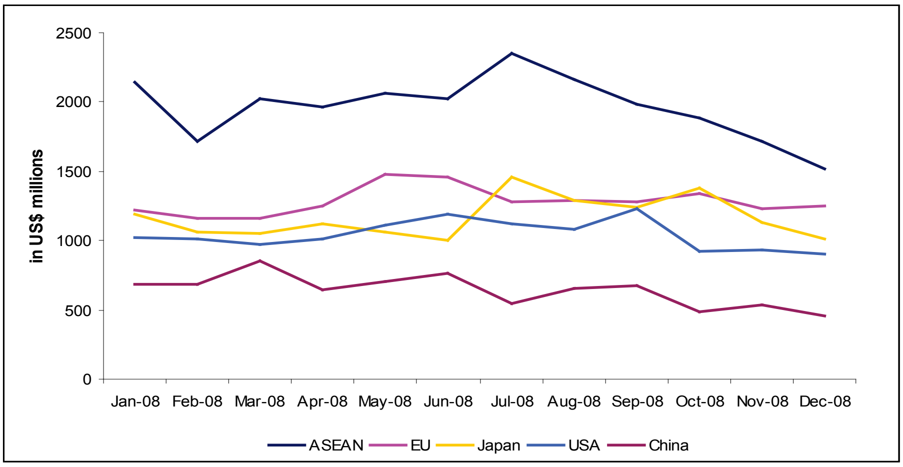
Table 2: Non-oil and gas exports by destination country, 2008 and 2009

	fob value (US$m)					
Destination	Jan 2008	Dec 2008	Jan 2009	Jan-Dec 2008	Change of Jan 2009 over Dec 2008 (US$m)	% share in non-oil and gas total, Jan 2009
ASEAN	**2142.1**	**1513.3**	**1262.4**	**23,496.5**	**-250.9**	**20.34**
1. Singapore	1068.3	706.7	594.5	10,112.5	-112.2	9.58
2. Malaysia	486.6	350.8	276.4	5971.2	-74.4	4.45
3. Thailand	240.9	162.9	143.5	3207.3	-19.4	2.31
Other ASEAN countries	346.3	292.9	248.0	4205.5	-44.9	4.00
Europe	**1223.0**	**1249.7**	**1026.8**	**15,334.7**	**-222.9**	**16.55**
4. Germany	199.0	181.9	171.8	2462.5	-10.1	2.77
5. France	80.4	76.6	64.7	936.0	-11.9	1.04
6. UK	118.8	109.0	101.6	1544.6	-7.4	1.64
Other European countries	824.8	882.2	688.7	10,391.6	-193.5	11.10
Other main countries	**3597.0**	**3088.5**	**2471.2**	**43,806.5**	**-617.3**	**39.82**
7. China	687.2	456.1	457.1	7765.2	1.0	7.36
8. Japan	1187.1	1007.3	788.0	13,821.6	-219.3	12.70
9. US	1017.2	907.0	772.3	12,527.2	-134.7	12.44
10. Australia	147.9	034.5	117.8	2094.2	-16.7	1.90
11. South Korea	347.3	329.4	219.4	4700.0	-110.0	3.54
12. Taiwan	183.3	254.2	116.6	2898.3	-137.6	1.88
Total of 12 countries	**5791.0**	**4676.4**	**3823.7**	**68,040.6**	**-852.7**	**61.61**
Others	**3156.7**	**2771.7**	**2382.5**	**39,812.1**	**-389.2**	**38.39**
Total non-oil and gas exports	**8947.7**	**7448.1**	**6206.2**	**107,852.7**	**-1241.9**	**100.00**

Source: CBS (March 2009).

Growth of the top 10 export products from Indonesia slowed down in January 2009. Exports to trade partners has dropped on a yearly basis: to ASEAN countries -41.1%, to the EU down -16%, to Japan -33%, to the US -24% and to China -33%. Particular products designated to these countries are rubber (US), palm oil (EU), coal and copper (Japan).

Figure 4: Export by destination country, 2008 (US$m)



Source: CBS (2008-2009).

For total non-oil and gas exports, falling demand among trading partners occurred beginning July 2008. Export to ASEAN countries (the biggest trading partner is Singapore) started a continuous declining trend in July 2008. Exports to Japan have also shown a similar trend since October 2008, whereas exports to major destination countries seemed flattened towards the end of 2008.

As export performance deteriorated, import numbers began to show signs of slowdown; after surging significantly up to the third quarter of 2008, imports started to tumble. All categories of imported goods declined in January 2009. The biggest drop was for imports of raw materials/auxiliary goods, which declined 38%. Coupling this drop with the decline in capital goods imports (-17%), these numbers could be reflecting worsening conditions in real/manufacturing industry activities. Table 3 also shows that consumption goods imports slowed by 26.3% compared with January 2008.

Table 3: Imports by economic category, 2008-2009

	Value (US$m) (cost, insurance and freight)					
Economic category	**Jan 2008**	**Dec 2008***	**Jan 2009****	**Change of Jan 2009 over Dec 2008**	**% change of Jan 2009 over Jan 2008**	**% share in imports total, Jan 2009**
Total imports	9608.1	7699.9	6342.6	-1357.3	-33.99	100.00
Consumption goods	648.4	499.1	477.9	-21.2	-26.30	7.54
Raw materials/auxiliary goods	7354.5	5007.5	4535.6	-471.7	-38.33	71.51
Capital goods	1605.2	2193.3	1328.9	-864.4	-17.21	20.95

Notes: * Preliminary figures; ** Very preliminary figures.
Source: CBS (March 2009).

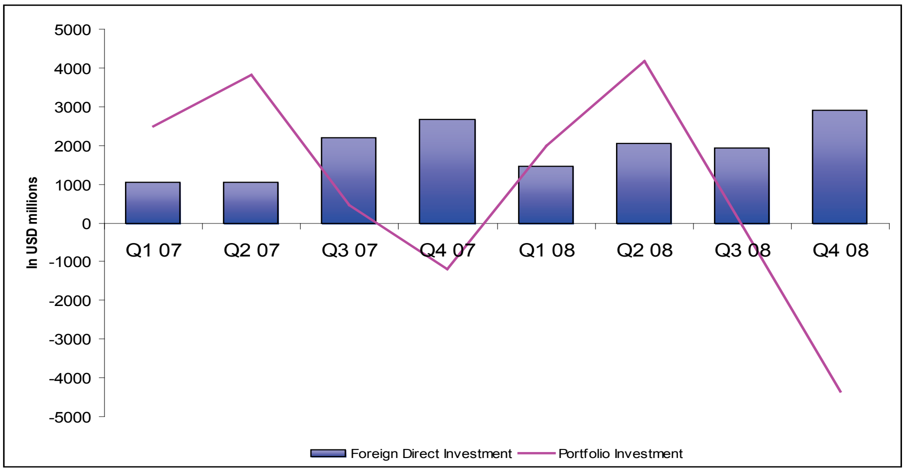
This worrying sign from imports, coupled with several indicators from business associations such as that sales of motor vehicles and electronic products plunged in the last quarter of 2008, may reflect further weakening of the real/business sector. Worsening developments in export–import transactions in the fourth quarter of 2008 clearly reflected latest trade balance data (see Annex 1). Fortunately, there was a significant decline in deficits of income balance as a result of reduced government dividend payment to foreign oil/gas contractors. In addition, a relatively steady flow of foreign tourists and workers' remittances (Section 2.3) contributed to a reduction of deficits in the current account balance.

2.2 Impacts on capital flows[2] (including stock markets and financial intermediaries, most notably banking sectors)

Financial contagion may have occurred swiftly as investors' appetite for emerging market diminished. Indonesia, which began to rely for development financing on debt securities and private sector financing after the 1997-1998 crisis, is now vulnerable to external shocks that result in disruption of foreign capital flows. Most foreign investments are short term and it is very easy to change course. While foreign direct investment (FDI) (considered more permanent) has increased since 2005, portfolio investment still takes up a great portion of foreign investment flows to the country – see Annex 1.

2 See Massa (2009). Financial contagion to developing countries may be identified through: i) spillovers towards financial market linkages and ii) pure contagion. The former includes spillovers through stock markets and financial intermediaries, whereas the latter consists in shifts in investors' market sentiment and changes in their perception of risks.

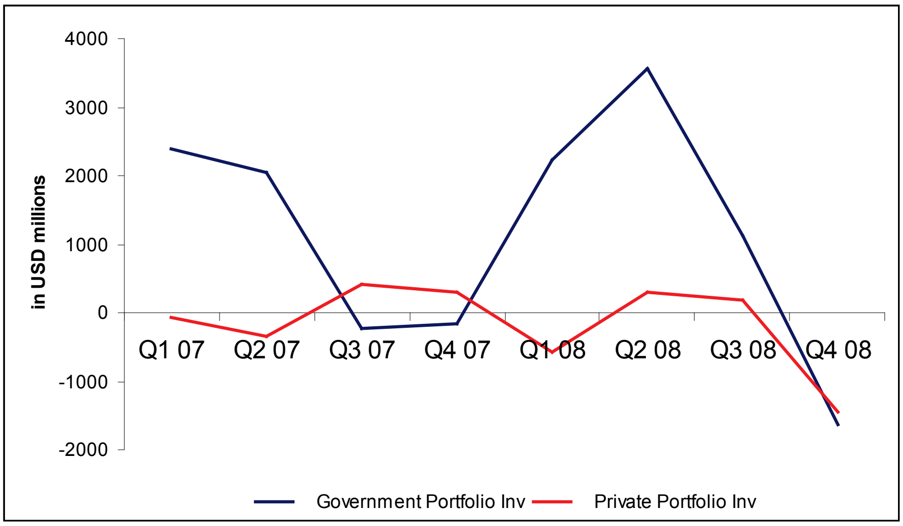
Figure 5: FDI and portfolio investment, 2007 and 2008 (US$m)



Source: Bank Indonesia (2008-2009).

According to the latest data from Bank Indonesia, FDI was still increasing in the quarter to December 2008, whereas portfolio investment had continued its declining trend since the previous quarter.

Figure 6: Portfolio investment by government and private sector, 2007 and 2008 (US$m)



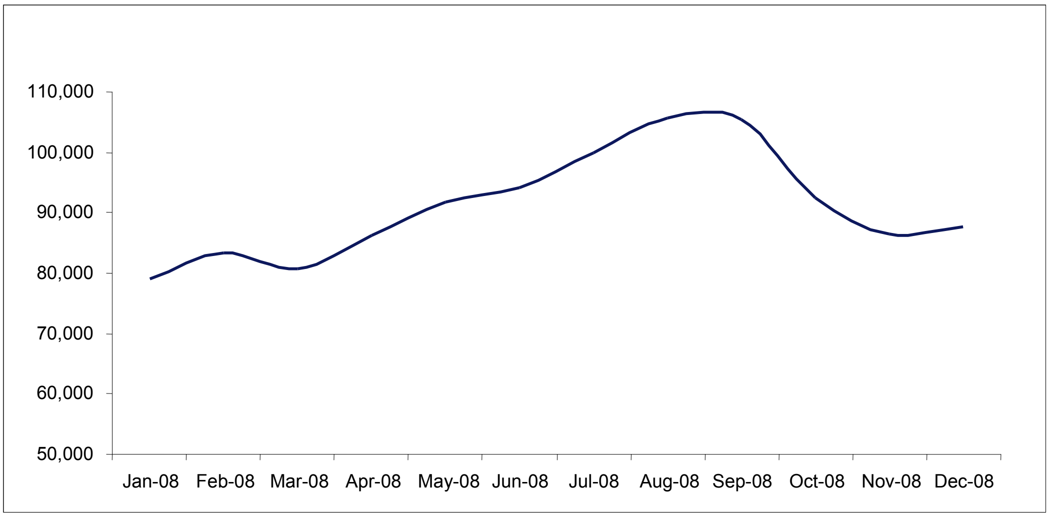
Source: Bank Indonesia (2008-2009).

Figure 6 shows that most foreign capital flow went to government securities, reaching a peak in the second quarter of 2008. During the last three months of 2008, a massive sell-off of government bonds and Bank Indonesia certificates by foreign investors put the capital and financial account of the balance of payments in deficit (see Annex 1). In addition, there was a significant increase in currency and deposit placements by private sectors abroad.[3]

Looking in more detail at the government financial account, we see that foreign holdings of government securities reversed course abruptly in mid-September 2008 when the Lehman Brothers bankruptcy was announced. This trend appeared to stabilise in November 2008.

3 See 'other investment' items in Bank Indonesia (2009a).

Figure 7: Foreign ownership of government securities, 2008 (IDR trillions)



Source: DMO (2009).

Prices of government securities have dropped owing to suddenly unfavourable emerging markets conditions – as pure financial contagion occurred when negative market sentiment and changed perception of risks set in. At the same time, the rupiah was already under depreciation pressure, and this produced a second blow for government bond prices. With these price drops, investors demanded higher yields. The yield spread[4] was increased from 411 basis points at the end of September 2008 to 716 at the end of the year (January data still recorded an increase to 754). At the end of October 2008, the 10-year tenor government bonds had even reached their highest peak of 20.96%. The government was forced to postpone the issuance of a new series of government bonds indefinitely.[5]

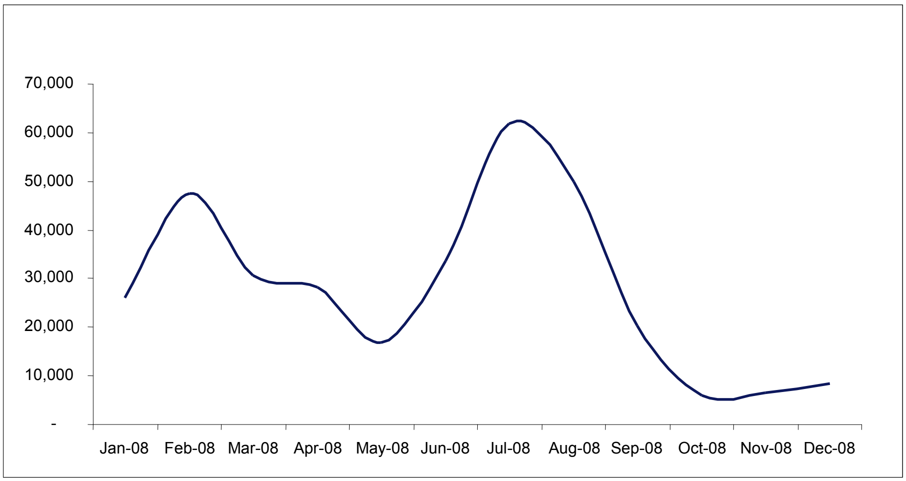
SUNs (government securities) yields declined towards the end of the year when the central bank cut the benchmark interest rate in early December. With inflationary pressure eased further, foreign holdings of SUNs at the end of the year increased slightly. Nevertheless, during the last three months of 2008, foreign holdings of SUNs dropped from US$11.1 billion to $8 billion.

Foreign ownership of SBIs (Bank Indonesia certificates) is always more volatile than is the case for government securities. A huge drop of SBI foreign holdings occurred in October 2008, recorded at IDR6082 trillion, after being IDR20,366 trillion in the previous month. For the period October-December 2008, foreign holdings of SBI certificates fell drastically, from US$2.2 billion to $772 million.

4 Indonesia's global bonds and US Treasury note.

5 See MoF (2008a). On 9 September 2008, the Ministry of Finance (MoF) decided to halt a government bond auction (series ZC0006, FR0027, FR0050) owing to the high yield premium requested by market investors. A week later, the government cancelled another auction plan on government bonds (SPN20090731, FR0026, FR0048), for similar reasons. Prior to this, the government was still issuing several series of government securities. Total government securities issued in 2008 reached IDR117 trillion (US$4.2 billion of this amount was issued as global bonds in international bond markets).

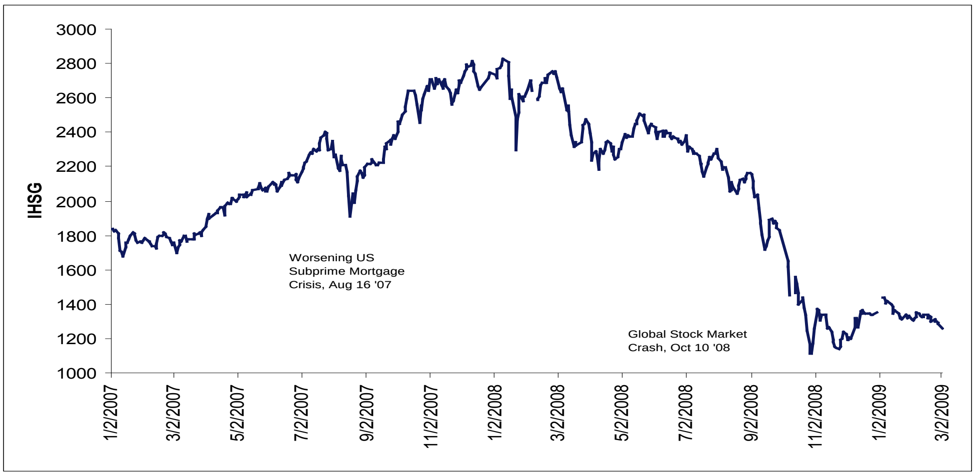
Figure 8: Foreign ownership of SBIs, 2008 (IDR trillions)



Source: Bank Indonesia (2009b).

The latest data on the private sector financial account showed that only FDI recorded a significant increase of almost 10% (year-on-year). Private portfolio investment and private other investment recorded deficits. On the liabilities side of private portfolio investment, a deficit of US$1 billion was recorded as equity transactions in the stock exchange plummeted, particularly in October 2008.

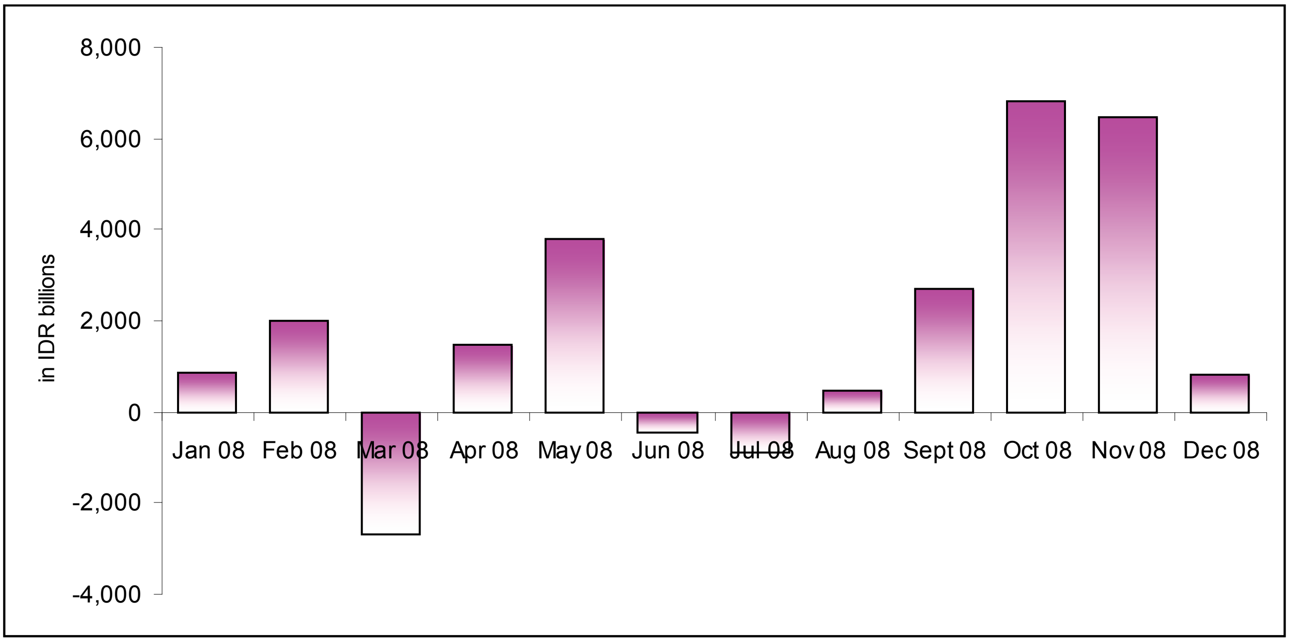
Figure 9: Indonesian Stock Exchange index, 2007-2009



Source: CEIC Asian database.

For the full year 2008, the stock exchange index fell 51.17%, with 26.04% in the last three months of the year. Market capitalisation for equity at the end of the year fell by 46.42%. The top 10 companies with the biggest market capitalisation on the stock exchange for 2008 are dominated by banking (Bank Mandiri, BCA), mining (Bumi Resources, Adaro Energy, PGN), plantation (Astra Agro Lestari) and telecommunication (Telkom, Indosat) companies. Only the last was considered as having a better outlook, owing to its domestic orientation. Banking, mining and plantation are predicted to be severely affected by the global crisis. Figure 10 shows volatile net equity foreign purchase during 2008.

Figure 10: Net equity foreign purchase, 2008 (IDR billions)



Source: Indonesian Stock Exchange (2008).

Based on data from the Indonesian Central Securities Depository, up to 24 December 2008, foreign ownership of equity on the Indonesian Stock Exchange was IDR436.3 trillion (67% of total equity market capitalisation), whereas local investors owned the remaining 33%, or 210.23 trillion. Compared with 2007, composition was relatively similar, with foreign ownership reaching 66% in December 2008.

In the corporate bond market, local investors were far more dominant, with 96% (of total corporate bond capitalisation/IDR67.74 trillion) of ownership. Foreign investors controlled around 4% (2.71 trillion). During 2008, corporate bond issuance occurred only in the first half of the year, worth approximately 11.9 trillion. This value was an extreme decline (61.94%) from total corporate bonds issuance in 2007, worth 31.27 trillion. There were three cases of corporate defaults in 2008, and many companies postponed their bond issuance plan, such PT PLN (the state electricity company) and Bank Danamon, Tbk. At least two factors were pointed out as the reasons why bond issuance by private sector dropped sharply in 2008: i) the high domestic inflation rate up to September 2008;[6] and ii) the looming uncertainties from the global crisis, reflected in the declining appetite of investors in capital markets, especially in emerging markets.

On the private 'other investment'[7] items, a deficit of US$1.7 billion was recorded at end-2008. On the liability side, a surplus of $2.1 billion was recorded – relatively unchanged compared with the surplus recorded in the previous quarter. The surplus owed to an increase of private sector external loan drawings of the Indonesian corporate sector, from $3.3 billion to $3.6 billion, while the Indonesian banking sector drew $0.5 billion of external loans. The increase in loan drawings was larger than the increase in private sector loan repayment – it rose from $2 billion in the previous quarter to $2.4 billion. At the end of 2008, the outstanding loan of Indonesian banks and corporations was recorded at $62.6 billion, consisting of $9.6 billion loan to banks and $53 billion to non-bank institutions. On the asset side, there was a huge increase of other investments by Indonesian residents in foreign countries – indicated by an increase of overseas accounts belonging to Indonesian banks. Net other investments

6 Inflation for 2008 was recorded at 11.06% (year-on-year). This was the highest annual rate in the past three years (2006: 6.6% and 2007: 6.59%).

7 Other investments are all residual categories including all financial transactions not included in direct investment, portfolio investment, financial derivatives and foreign exchange reserves. Other investment items consist of trade debt, loans, cash and other deposits. On the asset side, it includes domestic loan disbursement and other claims to non-residents (including domestic banks' nostro accounts); on the liability side, it includes loan drawings and other liabilities to non-residents (including banks' vostro account).

of the private sector financial account had a $1.7 billion deficit at the end of 2008 – much worse than the surplus of $500 million recorded three months before.

The possibility of adverse impacts may come also as a majority of foreign creditors of Indonesian banks and corporations are from Singapore (31.6% of Indonesian private sector outstanding external loans), the Netherlands (19.6%), Japan (13.6%) and the US (6.5%). Another possibility of disruption in foreign capital flows will come from the fact that most creditors do not have any ownership ties to the Indonesian side. Per September 2008, approximately 30.8% of outstanding private external short-term loans came from holding companies and/or affiliated businesses – the amount to mature in 2009 will be US$22.6 billion. It is argued that ownership ties to creditors will keep flows of external loans moving. Rollover and refinancing risks are more likely to occur to debtors without ownership ties to creditors.

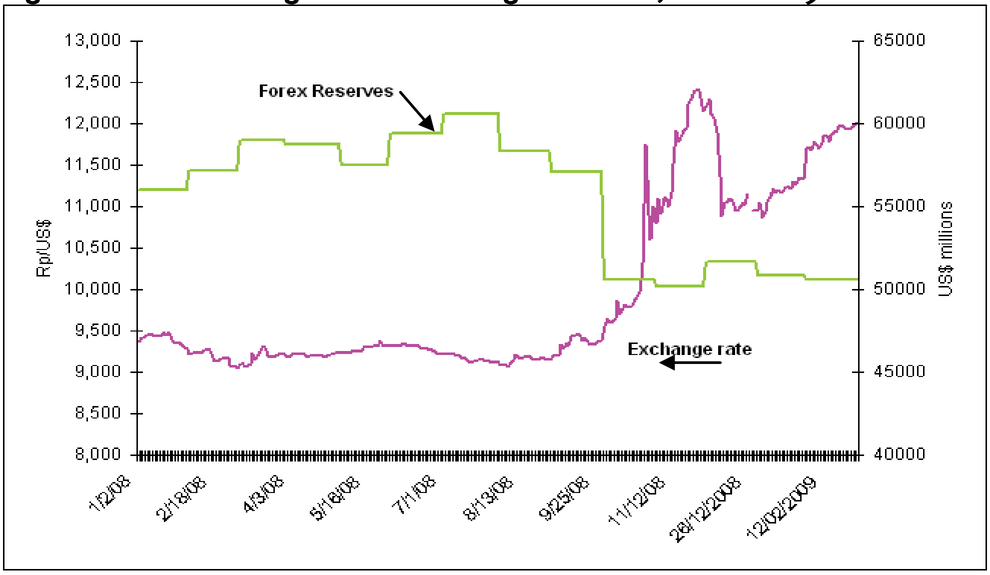
Table 4: Creditors' status, September 2008 (% outstanding)

Creditors	% outstanding
Holding companies	19.6
Affiliated companies	11.2
International institutions	0.6
Others	68.6
Total	100.0

Source: Bank Indonesia (2008d).

The rupiah had been under deep depreciation pressures and fluctuated greatly even after measures were put in action. In a year, the rupiah lost 16.9% of its value and up to 2 March 2009 it had already depreciated almost 10% from its value at the beginning of the year. Central banks' foreign exchange reserves had depleted by around US$7 billion in September-October owing to market interventions to prevent rupiah depreciation. Bank Indonesia appears to have abandoned market interventions since November 2008 and allowed the currency to be relatively free-floating.

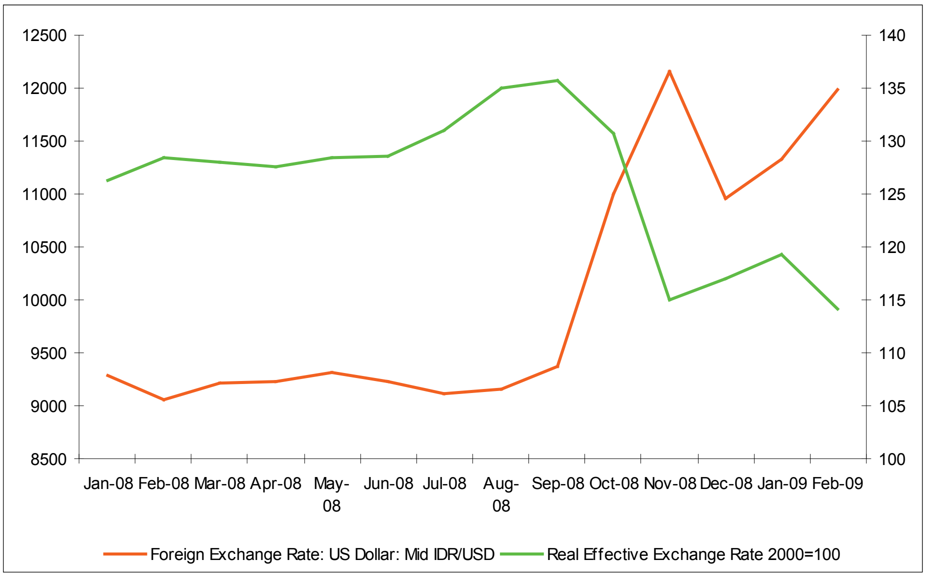
Figure 11: IDR exchange rate and foreign reserves, 2008-2009



Source: CEIC Asian database.

In February 2009, the rupiah was still under pressure, with a currency default swap still widening, from 539 to 643. According to data from Bank Indonesia and the MoF, total government external debt to be paid this year (2009) will reach IDR73.28 trillion, while repayment of domestic debt will reach 38.91 trillion. Total government debt payable this year is 112.19 trillion, the highest since 1998-1999. From the private sector, corporate bonds that will meet their due in the first semester of 2009 will achieve 8.8 trillion (for the whole of 2009, repayment will reach 13 trillion). Information on short-term external debts that needs to be paid in 2009 may be behind investors' jitters to hold a long position on the rupiah. In addition, the volume of foreign exchange reserves is perceived to be very thin owing to a significant drop in export revenues starting in October 2008. Figure 12 shows that nominal effective exchange rates dropped significantly in November 2008.

Figure 12: Nominal and real effective exchange rate (2000=100), 2008-2009

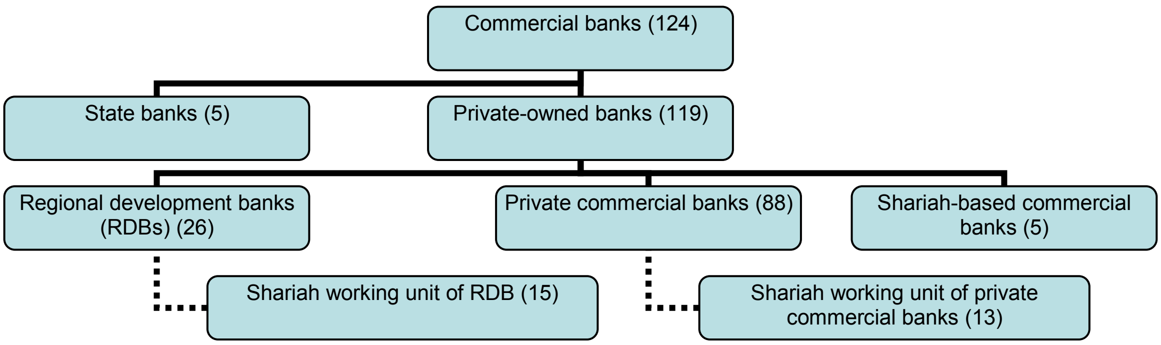


Source: Bank Indonesia and www.bis.org/statistics/eer/index.htm.

During the Asian crisis of 1997-1998, prudential regulation was finally legally enforced in the banking system, so in the wake of the current crisis there is no grave threat of a collapse of the banking system. In the latest report by the central bank (Bank Indonesia, 2008a), no financial institutions are identified as having direct exposure to any related sub-prime mortgage securities. There are at least two reasons as to why this is the case. First, none of Indonesia's banks has presence abroad, including in developed countries. This in itself limits their exposure to sub-prime mortgage-related securities, which are traded mainly there. Second, banks are not allowed to undertake investment activities such as purchasing securities and/or securities-based products (investment activities) or issuing and selling securities in capital markets. It should be noted that Indonesia does not have any investment banks.

Bank Indonesia noted that the banking sector in Indonesia currently consists of commercial banks (124) and regional/local credit banks (1897).

Figure 13: Commercial banking system, 2008



Source: Bank Indonesia (2008).

Regional/local credit banks are divided into 1769 conventional credit banks and 128 shariah-based banks. These banks have limited capital and are not part of the monetary authority payment system.

The latest available data on commercial banks show that, of the top 10 list of banks with the biggest assets up to March 2008, there are three state banks. The rest are mostly joint venture (JV) banks – the majority from neighbouring countries in the region such as Singapore, Malaysia and New Zealand. Only one foreign bank, Citibank, made it onto the top 10 list.

Table 5: Ownership structure of top 10 banks with biggest assets

		Type of bank	Assets (IDR trillions)	Foreign ownership (%)	Foreign owner(s)
1	Bank Mandiri	State	282,710	0.00	-
2	Bank Central Asia	JV	213,957	51.15	FarIndo, Mauritius
3	Bank Rakyat Indonesia	State	200,075	0.00	-
4	Bank Negara Indonesia	State	162,344	0.00	-
5	Bank Danamon Indonesia	JV	89,800	68.83	Temasek, Singapore
6	Pan Indonesia Bank	JV	55,137	35.00	ANZ, New Zealand
7	Bank Niaga*	JV	54,846	60.38	CIMB Group, Malaysia
8	Bank International Indonesia	JV	50,550	55.85	MayBank, Malaysia
9	Citibank	Foreign	43,558	100.00	US
10	Bank Permata	JV	41,224	44.50	Standard Chartered, UK

Note: * Bank Niaga merged with Lippobank under SPP in 2008.
Source: Bank Indonesia (2008) and Nuryanti (2009).

Main indicators such as the capital adequacy ratio (CAR), non-performing loans (NPL), loan-to-deposit ratio (LDR), return on assets (ROA) and net interest margin (NIM) still showed strong resilience towards the global crisis.

Table 6: Commercial banking performance, 2008 (%)

	Dec 07	Jan 08	Feb 08	Mar 08	Apr 08	May 08	Jun 08	Jul 08	Aug 08	Sep 08	Oct 08	Nov 08	Dec 08	Jan 09
CAR	19.30	21.60	21.00	20.52	19.39	18.26	17.58	17.44	17.10	17.26	16.70	16.77	16.76	17.82
ROA	2.78	3.16	2.93	2.72	2.56	2.62	2.53	2.68	2.71	2.64	2.68	2.60	2.33	2.69
LDR	66.32	67.06	67.89	70.66	71.65	72.80	73.89	76.00	79.02	77.72	77.48	77.60	74.58	73.76
NIM	5.70	5.70	5.56	5.64	5.60	5.60	5.65	5.69	5.73	5.73	5.69	5.65	5.66	5.56
NPL	4.07	4.24	4.21	3.75	3.82	3.76	3.54	3.50	3.42	3.32	3.34	3.49	3.20	3.59

Source: Bank Indonesia (2009 , various).

Banks' sources of fund came from depositors funds. These grew 16.16% (year-on-year) at the end of 2008. Growth in depositors funds[8] contributed to growth in time deposits (23.8%), demand deposits (6.14%) and saving deposits (13.6%). At the end of 2007, depositors funds grew 17.66% (year-on-year), with saving deposits as the biggest contributors to this growth (31.4% year-on-year), followed by demand deposits (19.87% year-on-year). Time deposits (which usually cost the most for banks) increased by only 9.11%. This is in sharp contrast with 2008, when time deposits grew almost 24% owing to a higher interest rate set by Bank Indonesia to dampen inflationary pressures from early 2008 (see Section 4). In January 2009, total depositors funds grew higher (18.4% year-on-year). The banking sector looked set to take advantage of uncertainties lingering in the stock exchange market owing to the global crisis. It is better to place money in a safer time deposit than invest it on the stock exchange.

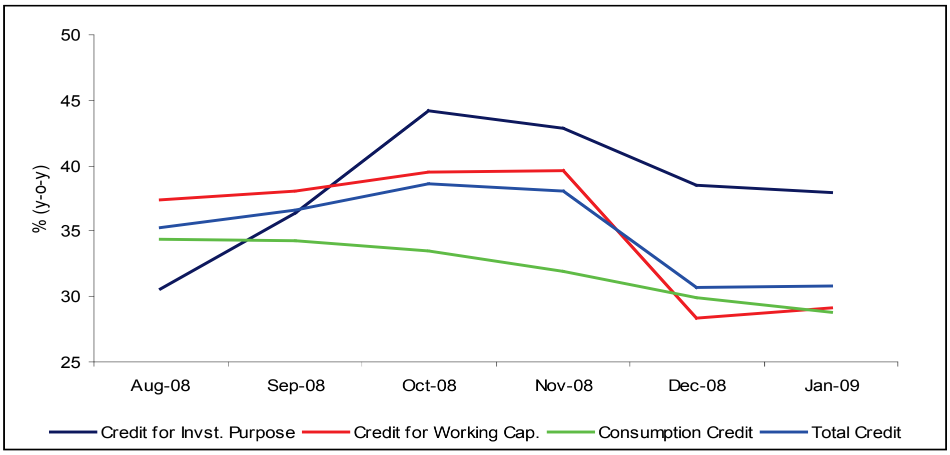
LDR was at 73.8% at end-2008. As it increased from 66.32% at the end of 2007 (see Table 6), NPLs stayed below 5%, that is, 3.59% (gross) (Bank Indonesia, 2009b) and 1.5% (net) (Bank Indonesia,

8 Most recent data on depositor funds growth are from December 2008.

2009c). However, this is an increase from 3.20% in December 2008, reflecting increased risks from corporate defaults owing to economic downturns.

Consumption credit expansion started to slow down from 34.21% (year-on-year) in September to 33.5% in October 2008. In November 2008 it grew even slower, by 31.9% (year-on-year). December 2008 and January 2009 saw even slower consumption credit growth, 29.9% and 28.8%, respectively. However, as Figure 14 demonstrates, while consumption credits had already slowed down, investment credits still grew. It was suspected that, owing to a drying-up of liquidity on the overseas financial market, domestic importers sought to find credits from domestic banking sectors during this period. Nevertheless, since October 2008, investment credits have also subsided.

Figure 14: Banking credit growth by type of use, Aug 2008-Jan 2009 (year-on-year growth %)



Source: Bank Indonesia (2009d).

When adjusted to the prevailing exchange rate, overall banking credit disbursement has actually slowed down. Growths of credit disbursement in rupiah became slower (year-on-year) – 37.1%, 36.7% and 30.5%, respectively, in October, November and December 2008 (Bank Indonesia, 2009b). Outstanding credit in foreign exchange also grew more slowly, by 19.7% in October 2008 – slower than the 28.6% growth in September 2008. As signs of weakening domestic demand were spotted early this year, there were great concerns regarding the Indonesian banking sector. It should be noted that, besides consumers, corporations from non-tradable sectors of the economy (such as trade, restaurants and hotels and other business service sectors) also have big shares in banks loans. Domestic purchasing power is a key factor in the bank business.

Throughout 2008, credit growth was persistently higher than growth of third-party funds in the banking sector. This certainly added to the liquidity squeeze faced by the commercial banks after September 2008. Commercial banks apparently financed their credit growth by selling some of their SUN holdings, because the SUN price continued to fall as a result of diminishing foreign investor appetite for emerging markets, reflected in the decline of banks' secondary reserves. But towards the end of the year, when signs of economic slowdown became very visible, commercial banks' holdings of SUNs were once again on the rise. The latest data show that commercial banks' holdings of SUNs increased from December 2008, from IDR258.75 trillion to 271.99 trillion in March 2009.

A similar trend is visible in commercial banks' holdings of SBIs. After being criticised for their preference in placing large holdings of low-risk and liquid SBIs rather than channelling funds to the real sector, the practice was slowly abandoned; since 2007-2008, commercial banks have kept their funds in a healthy proportion of SBI holdings and credit disbursements. However, SBI bank holdings recorded a steep rise from October 2008, increasing from IDR87.7 trillion (September 2008) to 124.42 trillion in October. Further, November and December 2008 also saw a rapid increase, to 152.3 trillion and 166.5

trillion.[9] With great uncertainty nowadays, banks appear to be taking safety and precautionary actions, rather than attempting to make a profit by disbursing credits to the crisis-vulnerable business sector.

The CAR of Indonesian banks was ample enough at 17.82% in January 2009. This is well above the Basel I benchmark of 8%. The central bank policy in this area was outlined in its blueprint of Indonesia's banking architecture: to increase banks' minimum core capital to IDR100 billion in 2010. Up to the end of 2007, all banks had successfully reached 80 trillion as scheduled in the blueprint (Bank Indonesia, 2008c). Complementary to this, the central bank issued its Single Presence Policy (SPP) in October 2006 (Regulation No. 8/16/PBI/2006) to limit bank shareholders to controlling interests in only one bank. Bank owners with such ownership can opt to merge, establish a holding company or sell one bank and keep one with controlling shares by the end of 2010.[10] As of this year, several bank owners have published their intentions: the controlling owner of Bank Niaga and Bank Lippo opted for a merger; the owner of Bank International Indonesia (BII) and Bank Danamon chose to sell BII to MayBank, Malaysia's biggest bank. While the private banks seems to be ready for the further consolidation imposed by the SPP, there has been no evidence that they have restricted access to capital financing.[11] However, the case for state-owned banks may be different, owing to limited government capital financing capacity. State banks aiming to seek alternatives to raise their own capital support for business expansion were forced to postpone their plans to issue bonds (such as was the case for Bank Mandiri[12] in December 2007 and BRI in the first quarter of 2008) after Bank BNI's rights issue and secondary offerings in late 2007 failed to gain satisfactory results.

A depreciated value of the rupiah would increase banks' risks. However, with banks' net open position (NOP) at 6.2% (of their capital)[13] up to December 2008, the banking sector seemed to cope with this, even if the rupiah is depreciated further by IDR5000 (Bank Indonesia, 2009d).

The sale of SUNs by foreign investors could also adversely affect banks – particularly as the Indonesian banking sector is the largest holder of tradable SUNs (IDR265 trillion as of 30 November 2008). The government took some action to buy back SUNs in the market in order to stop prices from sliding downward during 2008. Until the end of Semester 1 2008, SUN prices were down 15%. The Indonesian banking sector lost approximately 1.4 trillion as a result of marked-to-market[14] of banks' holdings of tradable SUNs (6.6% of total SUN holding in the banking sector). The remaining SUNs held by banks are held-to-maturity kinds. Compared with banks' revenues, reaching up to 220 trillion, this loss would seem trivial.[15]

2.3 Impact on workers' remittances

Data on worker remittances (net) up to end-2008 booked a relatively similar result as in the third quarter. Net workers' remittances accounted for approximately US$1.4 billion, relatively unchanged compared with the previous quarter. Worker remittance inflows were recorded at $1.6 billion (down from $1.7 billion in September 2008); at the same time, workers' remittance outflows (expatriate) were $0.2 billion.

9 Bank Indonesia (2009b). In the latest data on January 2009, commercial banks' SBI holdings increased even further to IDR208.51 trillion.
10 SPP implementation has been delayed by the central bank. No further timeframe is set to accomplish this.
11 So far, only one case of small bank failure has arisen owing to lack of capital financing.
12 Bank Mandiri managed to secure bilateral debt agreements to the amount of US$700 million to replace its bond issuance plan – uncertain market conditions were quoted as the main reason for not proceeding with the plan.
13 Bank Indonesia allows the NOP to stand up to 20%.
14 The marked-to-market valuation regulation was recently relaxed by the central bank owing to the global financial crisis.
15 Note that banks' unrealised loss of available-for-sale SUNs (SUN AFS) was recorded at IDR7.4 trillion. It seemed that banks had attempted to switch their portfolio from tradable SUNs to SUN AFS, reflected by a drop of tradable SUN holdings from 10-6.6% during the past six-month period.

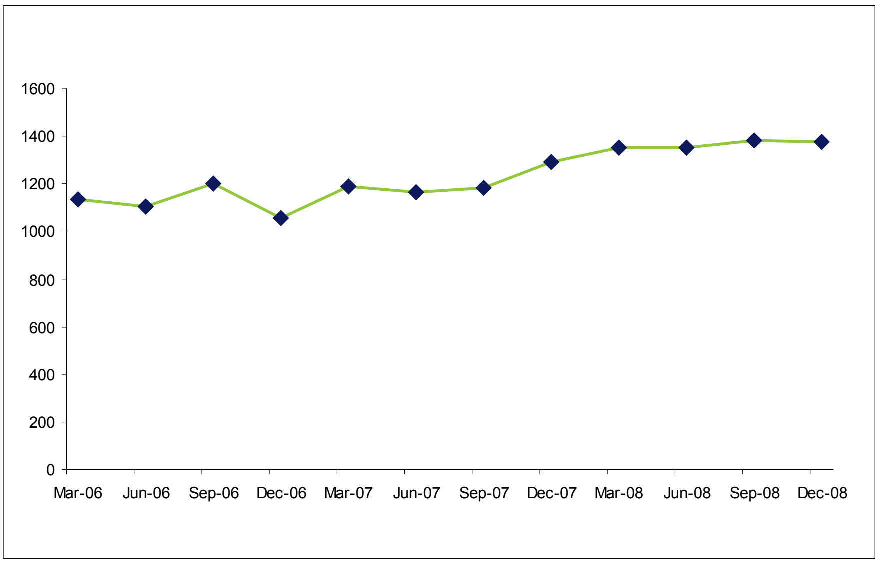
Table 7: Current transfer, 2007-2008 (US$ billion)

	2007				Total	2008				Total
	Q1	Q2	Q3	Q4	2007	Q1	Q2	Q3	Q4	2008
Current transfer (net)	1254	1178	1240	1432	5104	1373	1369	1423	1478	5643
Government (net)	58	34	30	58	180	17	27	38	128	210
Other sectors (net)	1196	1145	1210	1373	4924	1356	1342	1385	1350	5433
Workers' remittance (net)	1191	1166	1181	1295	4833	1354	1353	1381	1376	5464
Other transfers (net)	5	-21	29	78	91	2	-11	4	-26	-31

Source: Bank Indonesia (2009d)

Workers' remittances for 2007-2008 tended to increase in the last quarter, since workers usually send their income home for the celebration of Hari Raya Lebaran. See Figure 15.

Figure 15: Workers remittances (net), 2006-2008 (US$ billion)



Source: Bank Indonesia (2008-2009).

During the last three months of 2008 only, there was a 54% increase (quarter-to-quarter) in assignment of Indonesian workers to overseas destinations (around 258,000 workers, compared with 168,000 recorded at the end of September 2008). The total number of Indonesian workers working abroad up to December 2008 reached 4.4 million workers. Around 2.1 million worked in Malaysia, 1.4 million in Saudi Arabia and almost 1 million in Hong Kong, Taiwan, Singapore and the United Arab Emirates (UAE). Malaysia contributed the biggest share of remittance inflows (36%, or US$578 million in absolute numbers), followed by Saudi Arabia (34%, $547 million), Hong Kong (7%, $115 million) and Taiwan (6%, $95 million).

Table 8: Workers' remittances, 2008 (US$ billions)

Origin country	2007	Q1 2008	Q2 2008	Q3 2008	Q4 2008
Malaysia	2.60	0.64	0.64	0.62	0.58
Saudi Arabia	1.70	0.57	0.57	0.56	0.55
Hong Kong	0.42	0.11	0.11	0.14	0.12
Taiwan	0.36	0.09	0.10	0.10	0.10

Source: Bank Indonesia (2008-2009).

From Malaysia, it was predicted that workers would face layoffs owing to worsening conditions in the palm oil plantation and property construction industries – about 72% of Indonesian workers work in these two sectors. Similar bad news came from Saudi Arabia, where most Indonesian workers (99%) work as domestic helpers. The return of migrant workers to Indonesia will create more pressures on the domestic economy.

3. Impacts of global financial crisis on growth, employment and poverty reduction

The most recent data on Indonesia's GDP were released mid-February by the Central Bureau of Statistics (CBS). The annual growth rate, as predicted by most analysts, still reached slightly above 6% (6.1% year-on-year). However, growth for Q4 was down to 5.2% (year-on-year) and this was worse than many had predicted (at 5.7%). For 2009, the economy was estimated to grow 4-4.5%, with a big downside risk. Some of the projections are presented below, including government official estimates.

Table 9: Growth projections for Indonesia, 2008 and 2009 (%)

Institution	2008	2009
Asian Development Bank (ADB)	6.0	4.4
World Bank	6.0	4.5
International Monetary Fund (IMF)	6.0	4.5
The Economist	6.0	3.3
Bank Indonesia*	6.2	3.0-4.0
Government of Indonesia	6.2	4.0-4.5

Note: * Bank Indonesia just revised its projection (27 March 2009).
Source: Coordinating Ministry for Economic Affairs (2008), Bank Indonesia (2009, various).

Indonesia's huge consumption expenditure (which accounted for almost 70% of its GDP at the end of 2008) may have cushioned the impact of the global crisis so far. Table 10 shows the percentage of Indonesia's GDP by expenditure up to the end of 2008.

Table 10: Expenditure, 2008 (% of GDP)

Description	% of GDP			
	Q1 2008	Q2 2008	Q3 2008	Q4 2008
GDP: 2000p	100.00	100.00	100.00	100.00
GDP: 2000p: Consumption expenditures (CE)	63.84	64.67	64.09	69.22
Private CE	57.49	56.83	55.92	58.86
Government	6.35	7.84	8.17	10.36
GDP: 2000p: Gross fixed capital formation	23.53	24.73	24.35	24.68
GDP: 2000p: Net export of goods and services	10.30	10.39	9.58	10.92
GDP: 2000p: Statistic discrepancy	2.33	0.21	1.98	-4.82

Source: CBS (2009).

Table 11 shows the most recent data on growth in GDP by expenditure in 2008. Note that in the table the growth of government spending seems higher than other expenditure components. This owes simply to the budgetary process (most large disbursements occurred towards the end of the year). The export sector was particularly hard hit by the global crisis – growth was recorded at only 1.8% on a yearly basis, the lowest since 1986.

Table 11: Growth of GDP by expenditure, 2008 (%)

	Q1 2008	Q2 2008	Q3 2008	Q4 2008
GDP: 2000p	6.25	6.42	6.40	5.18
CE	5.47	5.49	6.34	6.42
Private CE	5.67	5.52	5.33	4.84
Government CE	3.62	5.26	14.06	16.35
Gross fixed capital formation	13.73	12.01	12.15	9.14
Change in stock	-408.22	-58.46	-61.27	-60.78
Statistic discrepancy	-27.96	26.15	-12.59	1568.11
Export of goods and services	13.64	12.36	10.63	1.82
Import of goods and services	17.99	16.11	10.97	-3.53

Source: CBS (2009).

By sector, the biggest contributor to Indonesian GDP is services (electricity, construction, transportation and communications, financial services and other services). The manufacturing industry accounts for more than 25% and resource-based activities such as agriculture and mining (including petroleum) contribute the remaining portion (approximately 20-21%).

Table 12: GDP sectoral composition, 2000-2008 (%)

	Share of agriculture in GDP (%)	Share of mining and quarrying in GDP (%)	Share of manufacturing industries in GDP (%)	Share of services in GDP (%)
2000	15.6	12.1	27.7	44.6
2001	15.3	11.0	29.1	44.6
2002	15.5	8.8	28.7	47.0
2003	15.2	8.3	28.3	48.2
2004	14.3	8.9	28.1	48.7
2005	13.1	11.1	27.4	48.3
Q1 2006	13.6	10.8	27.5	48.1
Q2 2006	13.1	10.8	27.6	48.6
Q3 2006	13.7	10.8	27.2	48.2
Q4 2006	11.5	11.5	27.8	49.1
Q1 2007	13.6	11.2	27.1	48.1
Q2 2007	14.1	11.0	26.9	48.0
Q3 2007	15.0	11.0	26.8	47.2
Q4 2007	12.2	11.4	27.4	49.0
Q1 2008	14.5	11.4	27.2	46.9
Q2 2008	14.5	11.8	27.3	46.5
Q3 2008	15.6	11.0	27.9	45.5
Q4 2008	13.0	9.8	29.0	48.2

Source: CEIC Asian database; CBS (2009).

In more detail for 2008, the manufacturing sector was still the single largest sector contributing to GDP (26.9%). Trade, hotels and restaurants was next, with a 17.72% share in GDP at the end of 2008.

Table 13: GDP structural composition, 2008 (%)

	Q1 2008	Q2 2008	Q3 2008	Q4 2008
GDP: 2000p	100.00	100.00	100.00	100.00
Agriculture, livestock, forestry and fisheries	13.79	14.26	14.74	11.80
Mining/quarrying	8.40	8.23	8.09	8.39
Manufacturing	27.06	26.70	26.55	26.86
Electricity, gas and water	0.71	0.72	0.71	0.74
Construction	6.23	6.20	6.17	6.53
Trade, hotels and restaurants	17.23	17.32	17.52	17.72
Transport and communications	7.69	7.80	7.86	8.55
Financial, ownership and business	9.59	9.47	9.30	9.84
Services	9.31	9.29	9.06	9.56

Source: CBS (2009).

The latest data show that slower growth rates were recorded for almost all sectors contributing to GDP growth. Manufacturing industry – the most export-oriented sector – growth dropped to 1.85% in the last quarter of 2008. Transportation and communications, considered a domestic-oriented sector, still maintained its high growth rate owing to strong increases in cellular phone subscriptions.

Table 14: GDP by sector, 2008 (%)

	Q1 2008	Q2 2008	Q3 2008	Q4 2008
GDP: 2000p	6.25	6.42	6.40	5.18
Agriculture, livestock, forestry and fisheries	6.32	4.80	3.43	4.74
Mining/quarrying	-1.65	-0.45	2.11	2.07
Manufacturing	4.28	4.23	4.31	1.85
Electricity, gas and water	12.35	11.77	10.41	9.34
Construction	8.01	8.12	7.57	5.67
Trade, hotels and restaurants	6.87	8.11	8.42	5.55
Transport and communications	18.33	17.32	15.53	15.82
Financial, ownership and business	8.34	8.66	8.60	7.42
Services	5.85	6.74	7.19	6.01

Source: CEIC Asian database; CBS (2009).

As mentioned above briefly, the Indonesian economy was in relatively good shape up to the third quarter of 2008. From 2007, average growth was above 6% on a yearly basis, and this resulted in declining numbers in both poverty indicators and the unemployment rate during 2008. According to latest survey[16] data published by the CBS in July 2008, the percentage of people living below the poverty line continued to decline, from 17.75% (2006) to 16.58% (2007) and further to 15.42% in March 2008. In absolute numbers, the number of people living below the poverty line was down from 39.3 million (2006) to 37.2 million (2007), further to 34.96 million people.

In March 2006, the poverty number increased significantly owing to the 'mini crisis' in Indonesia. It started with rising oil prices on international markets, when many foreign investors began to question Indonesia's state budget sustainability owing to its huge subsidy on domestic fuel prices. This confidence crisis resulted in substantial capital flight and approximately 30% currency depreciation, from IDR9100 to 12000. The government was forced to raise domestic fuel prices to cut the massive subsidy (amounting to US$14 billion) in October 2005. However, the country had to struggle with double-digit inflation rate of 17.11% for the year. The government introduced for the first time the direct cash transfer scheme to compensate the poor. About 15.5 million households were eligible to receive cash of IDR100,000 ($9 in 2005), paid on a quarterly basis.

Table 15: Absolute number and percentage of poor population, 1996-2008

	Number of people (millions)			%		
	Urban	Rural	Total	Urban	Rural	Total
1996	9.42	24.59	34.01	13.39	19.78	17.47
1998	17.60	31.90	49.50	21.92	25.72	24.23
1999	15.64	32.33	47.97	19.41	26.03	23.43
2000	12.30	26.40	38.70	14.60	22.38	19.14
2001	8.60	29.30	37.90	9.76	24.84	18.41
2002	13.30	25.10	38.40	14.46	21.10	18.20
2003	12.20	25.10	37.30	13.57	20.23	17.42
2004	11.40	24.80	36.20	12.13	20.11	16.66
2005	12.40	22.70	35.10	11.68	19.98	15.97
2006	14.49	24.81	39.30	13.47	21.81	17.75
2007	13.56	23.61	37.17	12.52	20.37	16.58
2008	12.77	22.19	34.96	11.65	18.93	15.42

Source: CBS (2008).

According to many observers,[17] there are at least three distinctive characteristics of the poor in Indonesia. First, the income difference between poor people (living below) and 'nearly poor' (just above) people is very narrow now. Nearly poor people are very vulnerable to basic commodity price increases, as 2006 demonstrated. Second, poverty measures used by the CBS in the survey mean that many people who live with income above the poverty line and do not have access to basic social needs

16 The latest survey used a higher poverty line measure of IDR182,636, up from 166,697/capita/month used previously.
17 See, for example, Sumarto (2008) and Swastika and Supriyatna (2006).

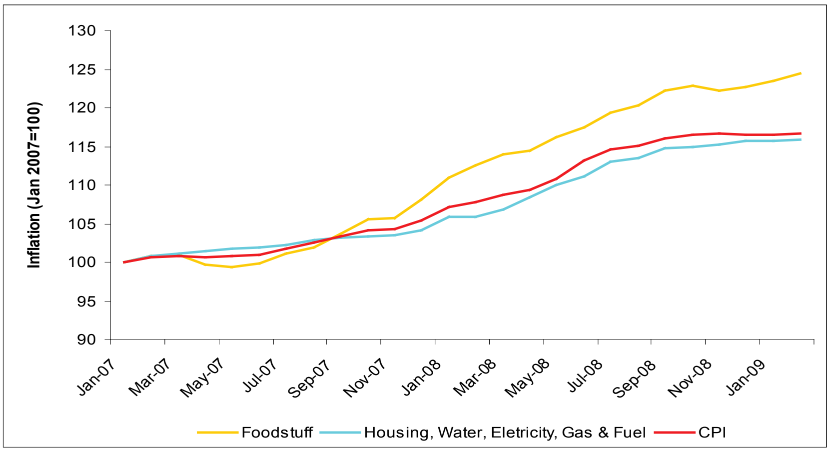
such as clean water are not included in the calculations of poor people. If these two characteristics were to make up the poor population, the number would reach almost 45% of the total population.[18] The third characteristic includes geographic factors as important determinants of poverty in each region in Indonesia.

The survey revealed that, for March 2008, rice spending contributed about 38.97% to poverty per capita expenditure in rural areas and 28.06% in urban areas. Other food commodities, besides rice, contributing significantly to the poverty line were sugar, instant noodles, egg, tempe and bean curd. In 2007-2008, the government continued to support a rice-for-the-poor programme (targeted households) to ease the increase in rice prices on the world market (up to US$600-800/tonne). However, this high price of rice on the world market was also behind the increase in rice production in Indonesia, providing incentives to increase land use and productivity. During the last quarter of 2008, the government made an announcement that Indonesia had achieved self-sufficient production of rice: a production rate of 38.6 million tonnes of rice and domestic consumption at 37.1 million tonnes.

Non-food commodities with a large impact on poverty per capita expenditure were housing and energy prices: in urban areas, housing contributed up to 7% to the poverty line and rural areas about 5.5%. Energy prices in Indonesia are set by the government. In 2005, the government raised domestic fuel prices twice. In March, the government announced a 30% increase on premium fuel prices (used widely for public transportation), but decided on no increase in kerosene, typically used by urban poor households. As of July 2005, the government did not provide a subsidy for kerosene used by industry. Next, in October, the government decided to increase the premium fuel price by almost 90% and the household kerosene price by 185%, from IDR700/litre to 2000/litre. The inflation rate soared to 17.11% in 2005 (in 2004, inflation was just 6.4% on a yearly basis). Fuel prices were increased again owing to heavy pressure from the international oil market last year. In May 2008, the government decided to increase the premium price by about 33% and the household kerosene price by 25%. In December, the government effectively cut the premium price as fuel prices on the international market began to decline (from July). Nevertheless, as in 2006, the increase in fuel prices resulted in double-digit inflation (11.06%). Again, the government cut the premium price in January 2009.

As illustrated by Figure 16, the increase in the foodstuff price index has been persistently higher than the inflation rate (measured by increases in consumer price index) since September 2007. A simulation by the World Bank (2008) suggested that, had food prices not risen by almost 15% between April 2007 and April 2008, the poverty rate would have decreased by two more percentage points. The CBS classification meant that the energy price index could not be analysed in isolation (it is under 'housing, water, electricity, gas and fuel' items). It stays more or less below the inflation rate – while the government raised fuel prices twice in 2008, it has maintained electricity rates constant since 2005.

Figure 16: General price, foodstuff price and housing price index movement, 2007-2009



Source: CBS (2007-2009).

18 Based on National Socioeconomic Survey (SUSENAS) data 2006 (see Sumarto, 2008).

Some of the government's poverty reduction programmes focus on maintaining economic growth to create more jobs. Table 16 shows Indonesia's open unemployment rate during 2005-2008. Along with the declining poverty rate, the number of people who looked for work but were not employed also declined, from 11.24% to 8.46%. While unemployment continued to decline, another problem lingering in Indonesia since the 1997-1998 crisis is underemployment and informalisation of labour markets (Sumarto, 2008). About 70% of the workforce in Indonesia is made up of informal workers with characteristics such as young, educated and dependent on their parents.

Table 16: Workforce and unemployment, 2009

	2005	2006	2007	2008
Working age population (millions)	158.49	160.81	164.12	166.64
Workforce (millions)	105.86	106.39	109.94	111.95
Working (millions)	93.96	95.46	99.93	102.55
Looking for work (millions)	11.9	10.93	10.01	9.39
Unemployment (%)	11.24	10.28	9.11	8.46

Source: CBS (2009).

The phenomenon of jobless growth has been pointed out as the most contributory factor in the persistently huge nearly poor population in Indonesia. A study by the UN Development Program (UNDP) and the International Labour Organization (ILO) (2007) showed that, with current economic growth (5-6%), a net of 1.2-1.4 million jobs have been created each year. However, new workers entering the workforce every year exceed these job opportunities in number, reaching 1.6-1.8 million people. Government estimates mention that, during 2007-2008, every 1% of economic growth would absorb 450-525,000 workers.[19] In 2008, the unemployment rate was 8.46% – almost double the 4.7% unemployment in 1997 before the Asian crisis set in. Still, the 2008 number was a slight decline from 9.11% in 2007. Official estimates from the government stated that, in order to reduce unemployment and poverty, economic growth must exceed 7% per year.

The unemployment rate in Indonesia will surely be affected by the current crisis. Since the crisis will most likely hit export-oriented sectors such as manufacturing (textile and textile products such as garments and shoes, electronic products and automotives), urban industrial workers will be vulnerable because factories are usually located in suburban areas – Jakarta, Banten, Surabaya (East Java) and Medan (North Sumatera). Another export-oriented sector that has already been hard hit is plantations, whose locations are concentrated in several provinces – North Sumatera (palm oil and rubber), Riau (palm oil), South Sumatera and Lampung (coffee, tea, cacao and other spices) and South Sulawesi (cacao).

Table 17 shows the likely effects of the global crisis on the unemployment and poverty rate. There are three scenarios, according to the government. The first is the 'without crisis' scenario, where economic growth reaches 6% per year. The second is where the global crisis affects the domestic economy without government doing anything (crisis without policies). The third is where global crisis affects the country but the government inserts a stimulus and other policies to cushion the impacts.

Table 17: Impacts of crisis on unemployment and poverty rates (three scenarios)

	GDP growth (%)	Unemployment projections (%)	Poverty rate projections (%)	
		Government	Government	World Bank
Without crisis	6.0	7.44	12.68	13.1
Crisis with no policies	5.0	8.87	13.34	13.9
Crisis with policies	4.0	8.34	12.93	13.8

Source: www.bappenas.go.id and World Bank (2008).

19 MoF (2008b). In the fiscal stimulus package, the assumption used was that each 1% of economic growth will create 431,000-450,000 new jobs.

From October-November 2008 up to end-February 2009, the Ministry of Manpower and Transmigration reported that 39,700 workers were laid off as results of the current crisis (including factory closures, order cancellations, etc.)[20] Most of these layoffs occurred in textiles and garments, wood and electronics, with West Java recording the most layoffs during the period (see Annex 2). Around 16,029 workers were suspended owing to idle capacity, the majority in wood furniture, plantations and pulp and paper industries. Government figures were far below the number of layoffs reported by Apindo (Indonesian Employers Association), which was between 150,000 and 200,000, including outsourced and daily workers (David and Baskoro, 2009).

As the Asian crisis and mini crisis in 2005 have demonstrated, the unemployment and poverty rates in Indonesia are very much influenced by basic commodity price movements (notably rice, sugar and cooking oil) and economic growth. Projections for poverty rates are based on expected growth of living costs. Since living costs have already fallen owing to lower fuel and commodity prices, both the government and the World Bank predict that the number of poor will still decline. No hyperinflation is expected (the inflation rate for 2009 is expected to reach 5-6% per year), and no natural phenomenon such as in 1997-1998. However, vulnerabilities of the nearly poor population will increase.

20 In a press conference on 5 March 2009.

4. Policy responses

4.1 Government policy responses

In response to worsening conditions in the global economy, the government of Indonesia has taken both reactive and proactive measures. The government and the central bank have made joint efforts to maintain financial market stability and to provide a fiscal stimulus in order to keep domestic demand growth at its usual annual rate. So far, the Indonesian economy has managed to be the only country in the Southeast Asian region that has had positive growth predictions this year (2009).

4.1.1 Maintaining financial market stability

Owing to the de-leveraging and re-pricing process, foreign investors fled emerging markets abruptly and created a liquidity crunch in international and domestic markets. Some policies taken to address liquidity issues were as follows:

- Lowering the overnight repurchase rate by 200 basis points from 12.25% to 10.25% at the end of September 2008 and at the same time increasing the overnight Bank Indonesia rate paid on funds that commercial banks deposit from 7.25% to 8.25%. In December, the overnight repurchase rate was again lowered from 10.25% to 9.75%, and the overnight Bank Indonesia rate was raised from 8.25% to 8.75%.
- Lengthening the tenor of foreign exchange swaps from seven days to one month.
- Cutting the minimum reserve requirement for rupiah[21] deposits from 9.08% to 7.5% and for foreign exchange deposits by commercial banks at Bank Indonesia from 3% to 1%.
- Introducing new regulations to allow commercial banks to use government bonds and/or SBIs worth 2.5% of their total rupiah deposits as secondary reserves. Big banks with large holdings of SUNs and/or SBIs will have more funds to channel loans since they are now allowed to do this (up to one year).
- Postponing implementation of accounting regulations with regard to fair valuation of assets, particularly the marking-to-market rules on banks' SUN holdings.
- Loosening limits on daily balance of short-term foreign loans: previously, commercial banks were required to limit the daily balance to no more than 30% of their capital.
- Requiring state-owned enterprises to place foreign exchange reserves in domestic banks.

Other measures were taken to address confidence issues by both government and the central bank. At the same time, these measures aimed at reducing speculative actions. These measures were:

- Increasing the amount of deposits in the banking system guaranteed by the government from IDR 100 million to 2 billion.
- Executing SUN buyback and preparing a state-owned enterprise equity buyback programme. The MoF has bought back IDR41 billion (US$3.89 million) worth of SUNs. State-owned enterprise shares buyback at the Indonesian Stock Exchange was undertaken through the Government Investment Centre (PIP) with available funds of IDR4 trillion (2.5 trillion was managed by PIP as reserve funds for infrastructure development and the remaining 1.5 trillion was managed by state-owned asset management company (PPA)). PIP appointed PT Danareksa (state-owned security firm) as a buyback broker.
- Maintaining a sufficient level of foreign reserves (end of December 2008 showed foreign reserves at US$51.6 billion – down from $60.6 billion at end-July 2008). The central bank has receded from its intervention in the foreign exchange market to support the rupiah and focused more on preventing too volatile movement of the rupiah.
- Putting some restrictions on short-selling on the capital market.

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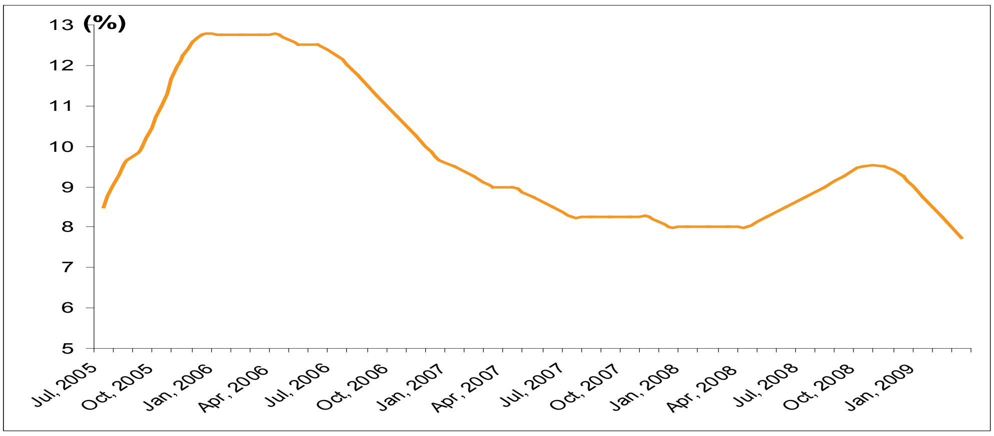
21 In its implementation, the minimum reserve requirement is set at 5% for statutory reserves. Bank Indonesia allows commercial banks to meet a 2.5% reserve requirement ratio set for secondary reserves in October 2009 (one-year extension).

- Limiting purchases of foreign currency without underlying transactions to US$100,000 to curb speculation. For Indonesians, the limits affect all transactions in spot, forward and derivative markets. They also have to produce their taxpayer registration number for banks when purchasing foreign currency. For foreigners, this applies to purchases on the spot market.
- Banning trading on banks' structured products/derivative products that provide chances for bank customers to purchase foreign currencies including dual currency deposits that are callable forward.
- Issuing a government Regulation in lieu of law on Financial System Safety Net (FSSN),[22] which included crisis protocols to be implemented by the Financial System Stability Committee, particularly to handle bailed-out banks (this regulation was rejected by Parliament in January 2009).
- Another regulation was issued on 5 January 2009 by the Ministry of Trade to support the rupiah (and the balance of payments), mandating export payments for certain products to use letters of credit (L/Cs) in domestic banks. Products with L/C requirements include coffee, crude palm oil, cocoa, rubber, mining products and tin.

Part of Bank Indonesia's efforts to stabilise the financial market condition, worsening from September-October 2008, were in keeping inflationary pressures at bay while supporting the rupiah from depreciating too much. The inflation rate – mounting from mid-2008, mostly because of increased basic commodity prices – reached 12.14% (year-on-year) in September 2008, and may have taken down domestic purchasing power. Under the circumstances, the central bank increased its interest rate benchmark to 9.5%. This was contrary to what other central banks in the region and across the world decided with the threat of global crisis looming – they lowered their interest rate. However, pressure has eased since then[23] and the bank has lowered its interest rate to the current level of 7.75% (4 March 2009). Bank Indonesia started a lower interest rate benchmark on December 2008 (currently, the interest rate is set at 7.75%) so the banking sector would be able to cut lending rates.

Figure 17: Bank Indonesia benchmark interest rate, 2005-2009 (%)



Source: Bank Indonesia (2009, various).

4.1.2 Fiscal stimulus package

Having assessed the latest data for the last three months of 2008, the government prepared for the worst in 2009. With a downward revision of the country's economic growth to 4%-4.7% at the most (previously 4%-5% maximum), the government expected investment growth would slow down to 5.9% and export growth would be stagnant (0% or even a decline at the rate of 3.0%). The state budget 2009 was revised to include an additional fiscal stimulus package to counter the impacts of the global crisis on unemployment levels and poverty reduction. On 24 February 2009, Parliament decided to approve

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22 At the same time, the government proposed two other Regulations in lieu of law, on Amendment of Central Bank Law (allowing the central bank to provide a short-term liquidity facility for banks encountering liquidity problems with collateral) and on Deposit Insurance Corporation (increasing the amount of deposits insured to IDR2 billion). These two were approved by Parliament.

23 The inflation rate was 11.06% in December 2008.

the package, adding IDR2 trillion to the original package proposed by the government, amounting to 73.3 trillion (2.6% of GDP). The fiscal stimulus package aims at:

- Maintaining/increasing household purchasing power to keep consumption growth above 4% (targeted consumption growth was set at 4.7%). Measures included: i) keeping supply-side inflation relatively stable (at 6-7% per year) by lowering energy and basic commodity prices through improvement of distribution channels; ii) providing tax saving to households through reduction of the personal income tax rate, raising the limit of non-taxable income to IDR15.8 million/year (previously 13.2 million/year); iii) introducing government-borne sales tax on cooking oil and non-fossil fuel/biofuels; iv) providing a direct subsidy for cooking oil and generic medicines. For measures ii)-iv) to stimulate household purchasing power, the government prepared a budget of IDR25.91 trillion. In addition, it will increase salaries of civil servants (including retired civil servants) and members of the military and the police by as much as 15% and offer a one-month bonus as well as distribute direct cash transfers in the amount of 100,000 (US$8)/month to 18.2 million targeted households for two months.
- Improving real sector resilience and competitiveness to prevent more workers layoffs. These measures included: i) relaxing the tariff for business income tax; ii) waiving duties on imported raw materials and capital goods for certain industries; iii) subsidising value-added tax on oil/gas exploration activities; iv) reducing the income tax tariff on geothermal companies; v) granting government-borne income tax for workers with a maximum monthly salary of IDR5 million for a one-year period; vi) cutting the diesel fuel price (used widely by industries) by 300/litre; vii) discounting the industrial electricity tariff; and viii) subsidising an interest payment scheme for water supply companies' loan disbursement. Government also arranged equity financing for Asuransi Ekspor Indonesia to support funding for an export guarantee scheme (after approval from Parliament, the original funds amounting to 1 trillion were cut to 250 billion). Government also arranged for equity financing for Askrindo and Jamkrindo, companies responsible for disbursing smallholder's credit programmes for the development of primary sectors. Funding for these measures was prepared to reach 35.43 trillion.[24]
- In addition, the government issued some trade-related policies. In November 2008, the Ministry of Trade announced that five categories of goods (food and beverages, garments, electronic goods, shoes and toys) can be imported only through five major seaports: Jakarta, Medan, Semarang, Surabaya and Makasar. After several delays, the regulation became effective on 1 January, but pre-shipment inspection was to take place on 1 February, except for garments, whose inspection has been in place since 2005. This policy aims to prevent illegal import activities that have flooded domestic markets with very cheap products. The government also strengthened enforcement of the Indonesian National Standard (SNI)[25] on steel, tires and packaged goods. On tariff policies, the government postponed implementation of the 2009 tariff harmonisation programme for 324 tariff lines – the same tariff as for 2008 applies. There were some temporary tariff increases owing to declining competitiveness; at the same time, the government reduced the tariff on some other imported primary and intermediary import products not produced domestically. In December 2008, the government and Bank Indonesia jointly announced a trade financing facility–export draft re-discount with recourse that will help banks to secure cash from L/Cs that have been issued. Related to export activities, Bank Indonesia also issued a new regulation allowing exporters to receive faster payments by permitting commercial banks to sell export receivables to the central bank in order to obtain fresh cash. The new regulation will also help in reducing demand for foreign exchange in order to manage depreciation pressures of the rupiah.
- Creating job opportunities for unemployed/laid-off workers by launching labour-intensive infrastructure projects. The government allocated IDR12.2 trillion for infrastructure spending

24 Previously, the government had set IDR1 trillion each for the export guarantee scheme (through ASEI) and expansion of credit programme (through Askrindo and Jamkrindo). However, Parliament approved only IDR250 billion for each as they considered the schemes would not contribute much to job creation.

25 Including requirements to use Indonesian language labelling on the product manuals to describe ingredients used in the products and to explain the working of electronic devices such as mobile phones and radios.

and an additional people empowerment programme.[26] Sectoral allocation of infrastructure development will focus on projects able to create more jobs, such as transportation (railways, airports, etc.), public housing, traditional markets and power generation.

Besides fiscal stimulus measures, the government has included social protection and poverty alleviation in the state budget for 2009. The budget allocated to education is as much as IDR207.4 trillion, to include improvement of education access and quality, such as school operational assistance, school building rehabilitation and teacher salary increases. In the health sector, the government has provided a free medical service at public health centres and third-class hospitals (allocation: 7.2 trillion). The government has also increased agricultural subsidies from 27.9 trillion in 2008 to 33.4 trillion, to support food security programming (12.9 trillion) and subsidise fertiliser (17.1 trillion) and seed procurement (1.4 trillion). The government has also proposed continuing its rice-for-the-poor programme in 2009 and directly selling subsidised cooking oil and soybeans in traditional markets in order to maintain reasonably steady prices in these basic commodities.

The fiscal stimulus package will decrease government revenue to US$77.6 billion and government expenditure will rise to $89.6 billion. Budget deficits will be around $11.8 billion (2.5% of GDP). This will be financed from a rollover of the unspent 2008 budget ($4.7 billion) and additional debt financing in the amount of $3.4 billion (from a standby loan from bilateral and multilateral sources). Government plans to maintain a net redemption of government securities in the amount of $4.9 billion. Given that the government debt ratio to GDP was 37% in 2008 and projected to be even lower in 2009 (33%), the financing scheme for the stimulus package looks secured. At the end of January 2009, government issued medium-term notes (global bonds) worth $3 billion as part of a deficit financing scheme. The MoF also issued new government retail Islamic bonds, and managed to collect IDR5.56 trillion (US$496.4 million). So far from these bond issuances, government has gathered IDR56 trillion. On 5 March 2009, the MoF announced that Indonesia had officially agreed on US$5.5 billion of loans from Australia ($1 billion), World Bank ($2 billion), ADB ($1 billion) and Japan (available as $1.5 billion-worth of guarantee on the yen-denominated bonds the government plans to sell – Samurai bonds). These loans will be used only if government fails to raise funds from bond issuance and other borrowings.

4.2 Early assessment on policy responses

Some measures taken to deal with the liquidity problem in the domestic financial market were deployed in October 2008 by using available instruments (reducing the reserve requirement ratio, relaxing accounting rules in marked-to-market asset valuation, etc.) In addition, in December 2008, Bank Indonesia cut the interest rate as much as 175 basis points. However, since medium and small individual banks still face a liquidity problem owing to inter-bank money market segmentation and ‘flight to quality’, commercial banks still charge relatively high interest rates. There has been only a slight decline in banks’ lending rates, from an average of 14.2% (December 2008) to 13.93% in the second week of March 2009, and deposit rates declined from 8.75% to 8.32%.[27] Recently, the government urged state banks to initiate a lending rate cut. It remains to be seen whether this will be successful, as the latest data on the Indonesian banking sector from January 2009 show that operational profits have been deteriorating owing to slower credit disbursement and increased provisions as a result of rising NPLS and declining interest income. Suggestions to mitigate inter-bank money market segmentation range from a full blanket guarantee on banks’ deposits to establishing pooling funds to address market segmentation in the inter-bank money market.

The fiscal stimulus package seems all good on paper, in terms of both budgeted funds and sector allocations. The important area for caution is whether the government will be able to start immediately, with many details in the package needing further elaboration. In past years, the government has been known to be very slow on budget disbursements. The year 2008 was particularly notorious in terms of

26 Expansion was intended to empower people living in rural areas. Through this, rural communities will formulate their own poverty alleviation programmes, starting from the planning stage up to the review and monitoring stage.
27 Press conference in March 2009.

disbursement timing. Up to the first nine months, the government was recorded as spending only 50.7% of the budget. Another problem that may delay fiscal stimulus implementation is regional governments' ability to complete their budgets on time. Up to January 2009, 57% (or only 293 regions) of all regional governments had not completed their budgets. The first quarter of 2009 will be the test case for Indonesia to consolidate its own strengths to mitigate the impacts of the global financial crisis. It will be very important for the government to accelerate this spending as soon as possible.

Meanwhile, it is difficult to determine at the outset whether the size of the stimulus is sufficient. This is partly because to claim otherwise requires counterfactual evidence, something that we do not have. On the one hand, during the 1997-1998 economic crisis, the government followed the IMF prescription of tight monetary policy coupled with fiscal discipline. Under such a prescription, the government could not use a fiscal stimulus to revive the economy. On the other hand, other countries' experiences may not be suitable to be used as comparisons; different countries have different initial conditions. Nevertheless, if there is one lesson that can be learned from the 1997-1998 crisis, it is that, even without fiscal and monetary stimuli, the economy emerged from the crisis relatively quickly.

5. Conclusion

Developments in the global financial crisis have clouded Indonesia's economic outlook. A combination of drops in commodity prices, slower global growth and tighter liquidity in financial markets across emerging economies has dragged down exports and investments. Both are keys to Indonesia's economic growth. So far, the impacts of the current global crisis have been severe to externally oriented sectors such as manufacturing industry, with the number of layoffs increasing since October-November 2008. Sharp rupiah depreciation and volatile capital outflows have added more pressures to the domestic economy.

Equipped with important lessons from the previous crisis (1997-1998), the government of Indonesia was quick to respond by combining both monetary and fiscal policy instruments in order to at least minimise global crisis impacts in Indonesia's election year of 2009. Swift action and lack of panic in the handling of the rapid depreciation of the rupiah since August 2008 have made all the difference, and the country has managed to avoid the sudden meltdown of 1998.

As the crisis is expected to worsen in developed countries, export and investment growth will be stagnant. Growth will be adversely affected. However, efforts to bring down unemployment and poverty should continue and these are very much influenced by the level of economic growth. Indonesia has now become dependent much more than before on its own spending as an engine of growth. Having assessed the situation, the government has prepared a stimulus package consisting of two parts. First is the tax saving programme, which will go directly to households and businesses; second is additional spending on infrastructure projects that are expected to create big multiplier effects in household and private sector spending. In addition, there are some factors that may keep household spending up and in turn support the effectiveness of the fiscal stimulus package, namely, low commodity prices on the international market owing to falling demand, good seasonal weather and the fact that 2009 will be Indonesia's election year, where electoral (both legislative and presidential) candidates spend money on their campaigns.

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Annex 1: Indonesia balance of payments statistics, 2007-2008

	Mar 2007	Jun 2007	Sep 2007	Dec 2007	Mar 2008	Jun 2008	Sep 2008	Dec 2008
Current account	2640	2271	2151	3430	2794	-1022	-943	-223
A. Goods, net (trade balance)	7712	8107	7487	9448	7536	5443	5772	4558
1. Exports, fob	26,626	29,202	30,009	32,177	34,412	37,345	38,081	29,452
2. Imports, fob	-18,914	-21,095	-22,521	-22,729	-26,876	-31,902	-32,309	-24,894
B. Services, net	-3163	-2991	-2764	-2922	-2992	-3374	-3316	-3331
C. Income, net	-3163	-4024	-3811	-4527	-3123	-4460	-4823	-2929
D. Current transfers, net	1254	1178	1240	1432	1373	1369	1423	1478
Capital and financial account	1836	2029	-935	660	-1395	2524	918	-3752
A. Capital account	43	127	255	122	52	73	200	29
B. Financial account	1793	1902	-1190	539	-1447	2451	718	-3781
1. Direct investment	-246	1426	764	309	-270	605	405	1739
A. Abroad, net	-1282	392	-1427	-2358	-1730	-1436	-1517	-1179
B. In Indonesia (FDI), net	1037	1034	2191	2667	1460	2041	1922	2918
2. Portfolio investment, net	2491	3810	465	-1200	1984	4188	-74	-4345
A. Assets, net	-497	-1897	-1257	-764	-823	60	-65	-434
B. Liabilities, net	2988	5707	1722	-437	2807	4128	-9	-3910
3. Other investment	-452	-3334	-2419	1430	-3160	-2342	387	-1176
A. Assets, net	-105	-2283	-2360	262	-2672	-1974	-1610	-3844
B. Liabilities, net	-348	-1051	-59	1168	-489	-367	1998	2669
Total	4476	4300	1217	4091	1400	1502	-25	-3976
Net errors and omissions	-97	-663	-37	-570	-367	-177	-63	-236
Overall balance	4379	3637	1179	3520	1032	1324	-89	-4212

Source: Bank Indonesia (2009, various).

Annex 2: Number of layoffs and suspensions, Oct 2008-6 Feb 2009

	Provinces	Sectors	Layoffs	Layoff plan	Suspension	Suspension plan
1	Nangroe Aceh Darussalam	Nihil				
2	North Sumatera	Plantations, rubber industry (tires etc.), food and beverages				10,000
3	West Sumatera	Palm oil industry	2			
4	Riau	Pulp and paper	1179	8720	1000	
5	Riau Islands		Nihil			
6	Jambi		Nihil			
7	Bengkulu		Nihil			
8	South Sumatera	Bread	112			
		Sawmills and plywood	1,081			
		Plastic			30	
		Animal husbandry	232			
9	Bangka Belitung					
10	Lampung					
11	Banten	Textiles	2740		1597	
		Transportation	46			
12	West Java	Electronics	800	400		6300
		Garments	800			
13	DKI Jakarta	Manufacturing	14,268	9757		
		Garments	1282			
		Food		90		
14	Central Java	Trade	182			
		Wood	1580		173	
		Food and beverages	52		120	
		Textile	2866		4978	
		Plastic	133		50	
		Paper	55			
		Cigarettes	497			
		Printing	8			
		Glass			500	
		Automotives	300			
		Chemicals	5			
		Outsourcing	24			
		Frozen shrimps	50			
		Iron nails	400			
15	East Java	Wood	60		125	
		Paper		300		
		Food and beverages				300
		Shoes	1314			
		Pulp and paper		500		
16	DIY	Cigarettes	16			
		Lamp industries	200			
		Handicrafts	165			
		Wood furniture	30			
		Plastic	12			
17	Bali					
18	NTB					
19	NTT					
20	West Kalimantan	Plantations	18	5050	485	
		Wood Manufacturing	300			
		Construction	38			

21	South Kalimantan	Plywood	600		600	
		Crumb rubber	259		100	
		Diamond mines	571			
		Coal mining	100		47	
22	East Kalimantan	Wood			3690	
		Pulp			784	
		Mining			300	
23	Central kalimantan	Plantation				2591
		Mining	32			
		Plywood	28			
24	Gorontalo		Nihil			
25	West Sulawesi		Nihil			
26	South Sulawesi		Nihil			
27	Central Sulawesi		NIHIL			
28	Southeast Sulawesi		43			
29	North Sulawesi		Nihil			
30	Maluku		515			
31	West Irian Jaya		Nihil			
32	Papua	Mining	70			
		Feed mill	42			
		Mining	15			

Source: Ministry of Manpower and Transmigration (2009).