BANK INDONESIA

For further information :
Short-term Outlook and Policy Dissemination Team
Monetary Policy Bureau
Economic Research and Monetary Policy Directorate
Phone : + 62 21 381 8180
+ 62 21 381 8163
+ 62 21 381 8119
Fax : + 62 21 345 2489
Email : bkm_tod@bi.go.id
Website : http://www.bi.go.id

# Monetary Policy Review
# November 2009

The Monetary Policy Review (MPR) is published monthly by Bank Indonesia after the Board of Governors' Meeting each February, March, May, June, August, September, November, and December. This report is intended as a medium for the Board of Governors of Bank Indonesia to present to the public the latest evaluation of monetary conditions, assessment and forecast for the Indonesian economy, in addition to the Bank Indonesia monetary policy response published quarterly in the Monetary Policy Report in January, April, July, and October. Specifically, the MPR presents an evaluation of the latest developments in inflation, the exchange rate, and monetary conditions during the reporting month and decisions concerning the monetary policy response adopted by Bank Indonesia.

**Board of Governors**

| | |
|---|---|
| Darmin Nasution | *Senior Deputy Governor* |
| Hartadi A. Sarwono | *Deputy Governor* |
| Siti Ch. Fadjrijah | *Deputy Governor* |
| S. Budi Rochadi | *Deputy Governor* |
| Muliaman D. Hadad | *Deputy Governor* |
| Ardhayadi Mitroatmodjo | *Deputy Governor* |
| Budi Mulya | *Deputy Governor* |

# Table of Contents

# I. MONETARY POLICY STATEMENT

**The Indonesian economy showed further improvement in October 2009 alongside the ongoing recovery in the global economy**. The most conspicuous progress is visible in Asia, where the Chinese economy is forging ahead as the engine of growth for the region. Bolstered by the China factor, Asia's economic growth is outpacing that of other regions. In advanced industrial nations, recovery is making headway with support from government-sponsored fiscal stimulus packages. However, the economic recovery process in developed economies and especially the United States remains daunted by risks such as high unemployment and slow improvement in income levels.

**Positive developments continue on global financial markets in line with the ongoing economic recovery and stable perceptions among money market actors**. Global stock market indices have climbed further while perceptions of risks in financial market assets in developed nations and emerging markets have improved, as reflected in comparatively stable figures for credit default swaps (CDS). The liquidity crunch that has beset global money markets is also easing. The present global economic recovery in tandem with rising commodity prices on world markets and the associated potential for escalating inflationary pressure has prompted some central banks to hold off cuts in their policy rates. In Asia's emerging markets, the more rapid recovery is expected to prompt changes in monetary policy stance in anticipation of mounting inflationary pressure. However, in developed economies, the accommodative monetary policy stance is predicted to continue until next year, given the current high rates of unemployment and lack of strong progress in economic recovery. In view of these developments, capital inflows are predicted to keep pouring into emerging markets.

**At home, the various developments in the global economy have provided a boost to Indonesia's economic performance**. In the external sector, improving conditions in regional economies and the share of global trade dominated by raw materials and intra-industry trade within Asia have contributed to more robust export performance in Indonesia. Domestically, brisk growth in private consumption in response to improving public optimism and subdued inflation is the main factor sustaining Indonesia's economic growth. Investment is predicted to chart increased growth over the preceding period, bolstered by government capital expenditures and optimism for strengthened demand reflected in rising cement consumption and initial recovery in capital goods imports. Overall, the Indonesian economy is predicted to chart higher growth in Q4/2009 compared to one quarter earlier.

**Concerning prices, inflation eased further in October 2009 while staying below the historical trend**. Key to the low October inflation was the appreciation in the rupiah and declining public expectations of inflation, with core inflation sinking further to an unprecedented low. In response to these developments, inflation in 2009 is forecasted at the lower end of the 4.5%±1% (yoy) inflation targeting range. Looking forward, inflation in 2010 is predicted to return to normal at 5±1% in keeping with renewed vigour in domestic economic activity and resurgent commodity prices.

**The ongoing improvement in exports and capital inflows augurs for strengthened performance in Indonesia's Q4/2009 balance of payments, again projected to chart a surplus**. The gathering momentum in the global economy will provide an added boost to the current account. The capital and financial account also charted an estimated surplus on the back of steady inflows of foreign portfolio capital spurred by growing risk appetite for emerging market assets and sentiment over the weakening of the US dollar. External financing has also mounted on improving expectations for the domestic economy and the upturn in global economic conditions. In response to these developments, the international reserves position at end-October 2009 widened to 64.5 billion US dollars. This improvement in external sector fundamentals contributed to the appreciation in the rupiah during October 2009.

**In the domestic financial sector, financial markets reported overall gains**. Recovery of investor confidence has paved the way for renewed capital inflows, despite short-lived correction at the end of the month. The bond market has seen foreigners take up larger positions in response to modest increase in short-term and medium-term yields. On the stock market, the index surged past the 2,500 mark before sustaining correction from profit taking and fallout from global market turbulence. Money market conditions were marked by ample bank liquidity alongside reduced market segmentation. Monetary policy transmission carried forward in the financial sector as reflected in the ongoing decline in deposit and lending rates, despite the absence of change in the BI Rate since September 2009.

Domestically oriented lending such as consumption credit recorded brisk growth, but export-oriented sectors saw very limited credit expansion. Looking forward, further improvement is predicted in monetary policy transmission in keeping with the more positive perceptions of the economy among actors in the real sector and banking system and bank commitments to lower interest rates.

**Conditions in the banking system also reflect ongoing stability at the micro level**. Indicating this is the still comfortable level of the capital adequacy ratio (CAR) at 17.7% in September 2009. At the same time, the gross non-performing loans (NPLs) ratio held within safe limits below 4.3% with the net NPLs ratio at less than 1.3 %. Banking liquidity, including liquidity on the interbank money market, has shown further improvement alongside growth in depositor funds.

**On 4 November 2009, the Bank Indonesia Board of Governors Meeting decided to hold the BI Rate at 6.5%. The key considerations in this decision are that the 6.5% rate is consistent with the 5% ± 1% inflation target for 2010 and the present monetary policy stance is also regarded as conducive to economic recovery process and banking intermediation**.

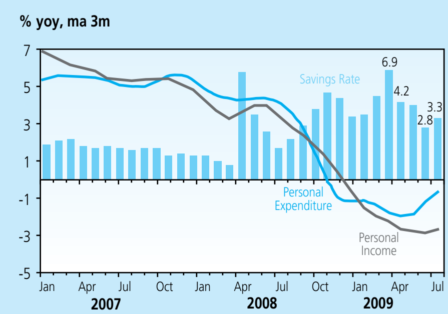
## II. THE ECONOMY AND MONETARY POLICY

Indonesia's economic performance has improved further in response to high demand and recovery in the global economy. Estimates point to resurgent household consumption on the back of stable public purchasing power and sustained consumer confidence. In regard to prices, October 2009 posted remarkably low inflation, following the end of the Eid-ul-Fitr festive season. On other fronts, stock market performance was generally stable, despite some temporary correction at the end of the period. **Conditions in the banking system also reflect ongoing stability at the micro level**.

### Developments in the World Economy

**The global economic recovery process is gathering momentum**. The most conspicuous economic recovery is visible in Asia, driven by the economy of China. Solid expansion in China's manufacturing has stimulated demand for imports from other Asian nations, in so doing boosting economic growth in the region. Also driving manufacturing growth is positive monthly growth in fixed asset investment and capital inflows (FDI). Asian economies are showing generally positive results with key support coming from domestic demand. With the brisk pace of growth in China's economy, Asian economies are growing faster than other regions.

Economic conditions in developed nations and particularly the G3 are also improving. Economic recovery continues in response to the implementation of fiscal stimulus packages, as reflected in strengthening indicators of domestic demand in the US. In Europe, industrial expansion in Germany and discount incentives to buy new cars have provided a boost to retail sales. Over in Japan, unemployment is easing as a result of expansionary measures taken by Japanese corporations. A Japanese survey also points to strengthening consumer confidence, bolstered by growing optimism for Japan's future economic growth. Despite this, economic recovery in developed economies and especially the United States continues to be daunted by risks such as stubbornly high unemployment and slow improvement in income levels.

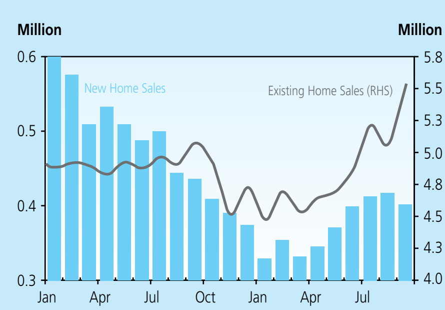


Source: Bloomberg

**Graph 2.1** US Household Real Income Spending

**The slowdown in US household consumption is predicted to ease with help from the fiscal stimulus, although the economy remains beset by high unemployment (Graph 2.1)**. US household incomes are still under pressure from high unemployment levels, tight lending by banks and the diminishing impact of the fiscal stimulus. On the labour market, the surge in worker lay-offs continues, but has begun to ease as reflected in the drop in average initial jobless claims to 526 thousand in October compared to the previous 549 thousand. In most countries, household consumption is on the rise, as evident from retail indicators. The US cash for clunkers programme has boosted car sales and strengthened consumer confidence in the future outlook for the economy.

**The US housing crisis appears to be over, but conditions are still not fully stable**. The actions taken by the Fed and the US government in bringing down interests rates on home mortgages and injecting liquidity into the money market have calmed the turbulent housing sector. In related developments, the impact of low interest rates and affordable housing prices has triggered a round of new and existing house sales (Graph 2.2). Housing starts and building permits, both leading indicators for the housing sector, are also on an upward trend in line with more buoyant confidence



Source: Bloomberg

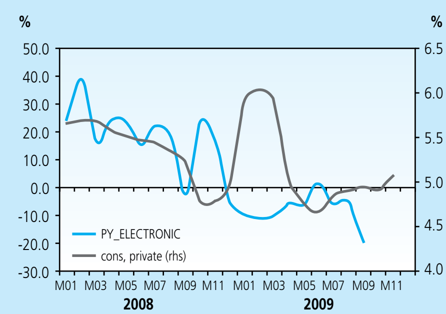
**Graph 2.2** New and Existing House Sales among developers for the future. Increased housing purchases have produced in an increase in the S&P/Case-Shiller composite housing price for the fourth time this year.

**US production has now entered an expansionary phase**. Manufacturing is on the rise, as evident from the improving trends in the Purchasing Manager Survey (PMI) and industrial production surveys. Even the services sector, which accounts for nearly 90% of total industry in the US, had embarked on an expansionary phase during September 2009. Companies are drawing down stocks amid rising sales. Looking forward, after stocks are down to safe levels, production is expected to rebound with renewed expansion in production capacity.

**Global financial markets are charting positive gains in keeping with the ongoing economic recovery and stable perceptions among money market actors**. Index gains on global stock markets have been fuelled by better than expected results in financial statements published by stock issuers and positive sentiment for global economic recovery. Accompanying this is a general improvement in risk perceptions for financial market assets in developed nations and emerging markets, as reflected in comparatively stable figures for credit default swaps (CDS). The liquidity crunch on global money markets is also easing. Asian financial markets are charting gains on the back of improving global financial market conditions.

**Estimates of global inflation for the year as a whole are climbing, albeit still at a low level**. The global inflation estimate for 2009 mounted slightly in October 2009 to 1.70% (yoy) from the previous 1.65% (yoy). The rise in the inflation forecast is explained by more robust world economic activity and escalating international oil prices. Inflationary pressure in developing nations is estimated at 3.89% (yoy), while in advanced economies inflation is put at 0.04% (yoy).

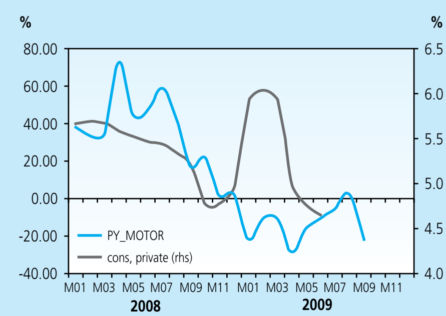
**In most advanced nations, the downward movement in policy rates is levelling off**. The present global economic recovery in tandem with rising international commodity prices and the associated potential for mounting inflationary pressure has prompted some central banks to hold off cuts in their policy rates. In many countries, with the exception of Australia, authorities have continued with accommodative monetary and fiscal policy responses to sustain momentum amid subdued inflationary pressure. During October, most central banks in advanced economies, such as Europe, UK, Japan, Canada and Sweden, stayed the course in their monetary policy responses while refraining from further rate cuts in their efforts to boost economic recovery. Even so, Reserve Bank of Australia (RBA) decided on renewed tightening by raising the reference rate by 25 bps to 3.25% in order to prevent an asset bubble and curb growing inflationary pressure. The more rapid recovery in Asia's emerging markets is expected to prompt changes in monetary policy stance to anticipate the likelihood of mounting inflationary pressure.




**Graph 2.3** Sales of Electronic Product

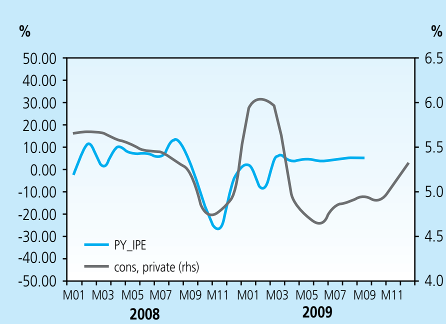
## Economic Growth in Indonesia

**Economic growth is forecasted to climb further in Q4/2009 in line with improvement in global demand and economic conditions**. On the demand side, household consumption is predicted to chart accelerated growth on the back of stable public purchasing power and safe levels of consumer confidence. Exports are forecasted to mount further with support from rising demand in trading partner nations and higher commodity prices. Investment is therefore projected to grow more briskly than in the preceding quarter, buoyed by more robust demand and business optimism. Imports are predicted to resume more vigorous growth, responding to indications of strengthening domestic and external demand. On the supply-side, key sectors, such as manufacturing, trade and agriculture, are expected to chart improved growth in Q4/2009. These sectoral performance gains will be driven mainly by more vigorous domestic and export demand.

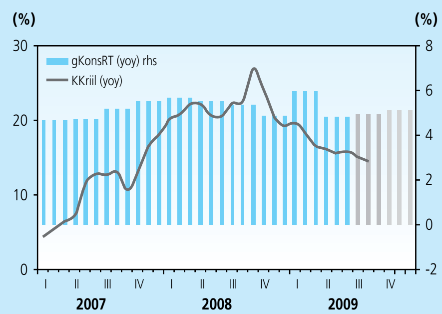



**Graph 2.4** Car & Motorcycle Sales Growth vs GDP: Private Consumption Expenditures

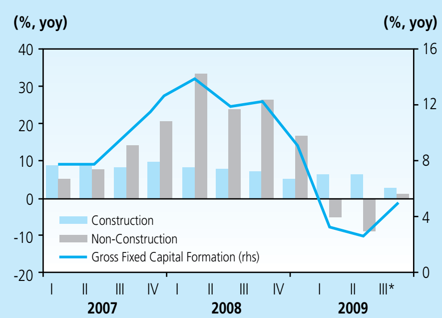
**Household consumption in Q4/2009 is predicted to chart more rapid expansion compared to the preceding quarter**. The upbeat forecast for household consumption is consistent with the ongoing developments in leading household consumption indicators pointing to gains. Supporting this household consumption growth will be stable purchasing power levels resulting from improved export performance and sustained levels of consumer confidence. Movement in leading indicators also points to increased household consumption. The retail index showed improved growth at end-Q3/2009, bolstered by increased consumption in the clothing and accessories category and in food and tobacco. Imports of consumer goods were also up in August 2009. Despite this, consumption indicators pointed to slowdown in durable goods, such as growth in sales of cars, motorcycles and electronic goods during September 2009 (Graphs 2.3 and 2.4), a development explained by the fewer days of business



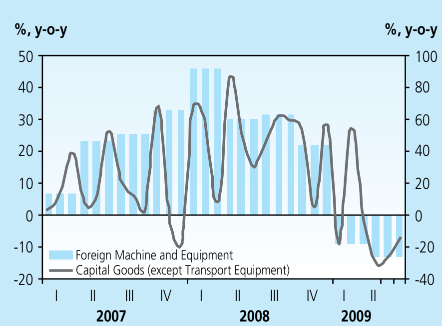

**Graph 2.5** SPE BI : Industrial Production Index




**Graph 2.6** Consumption Financing Sales




**Graph 2.7** Construction & Non-Construction Investment Growth




**Graph 2.8** Foreign Machine Investment

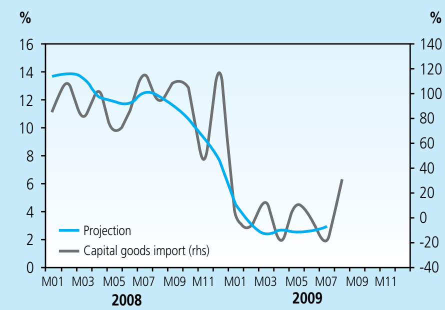
during the Eid-ul-Fitr festive season. Alongside this, consumer financing-related indicators such as real M1 recorded higher growth in advance of the festivities (Graph 2.6), while growth in consumption credit maintained a generally stable trend.

**Investment growth (gross fixed capital formation) is predicted to improve in Q4/2009 in line with strengthening external and domestic demand**. In structural terms, construction is again predicted to provide the major source of investment growth in Q4/2009 (Graph 2.7). Signs of this growth are also visible in various leading investment indicators (Graphs 2.8-2.10). Improved growth is also visible in non-construction investment, reflected in higher imports of capital goods. In related developments, cement consumption growth, a leading indicator for construction investment, was up in mid-Q3/2009 following the expansion under way in ongoing construction work and infrastructure projects. In regard to financing, improvement was also recorded in investment credit expansion at mid-Q3/2009.

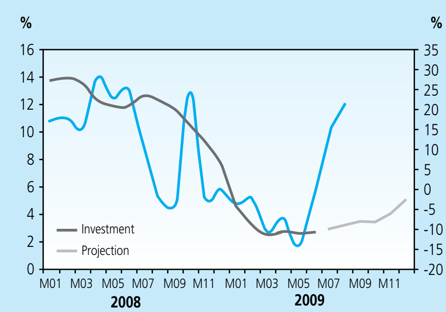
**As economic conditions pick up in trading partner nations, stronger exports are predicted for Q4/2009**. Indications of improved export performance are reflected in rising demand from advanced economies, such as the United States, Japan and Europe. Furthermore, the upswing in production indices, consumer confidence indices and business sentiment in the G3 and China also augurs for higher export growth. Indications of improvement are also visible in the expanding volume of global trade, reflected in the gains in the Baltic Dry index as of early Q4/2009. At the same time, trade with other nations, such as India, is predicted to mount in response to conclusion of the Free Trade Agreement (AI-FTA) between ASEAN countries and India. In regard to export financing, the inauguration of the Export-Import Bank (LPEI) and deferment of L/C obligations during the second half of 2009 is expected to bring more financing on stream for export activities. Analysed by sector and the HS 2-digit commodity classification, export demand in August 2009 was again driven by performance of primary agricultural commodities such as CPO, rubber and rubber products.

**Higher growth is also forecasted in Q4/2009 for imports, due to the effects of rising domestic and external demand**. The outlook for stronger import growth is consistent with the upward trend in household consumption and demand for raw materials and capital goods for manufacturing sector production. Besides this, indications of more vigorous import growth are confirmed by more sharply rising import duties. The major factor contributing to import growth, like before, will be renewed growth in imports of raw materials and intermediate inputs.

**Further gains in sectoral performance are predicted for Q4/2009**. Key sectors, such as manufacturing, trade and agriculture, are expected to chart accelerated growth. This improvement in sector performance is linked to the onset of more vigorous domestic and export demand. Alongside this, other sectors, such as electricity, gas and water utilities and the transport and communications sector, will maintain brisk growth. In analysis by structure, the dominant sectors of the economy are the traditional mainstays of manufacturing, the trade, hotels and restaurant sector and agriculture. However, the most important contributors to growth will be transport and communications, agriculture and the financial services, leasing and corporate services sector.




**Graph 2.9** Capital Goods Import and Gross Fixed Capital Formation

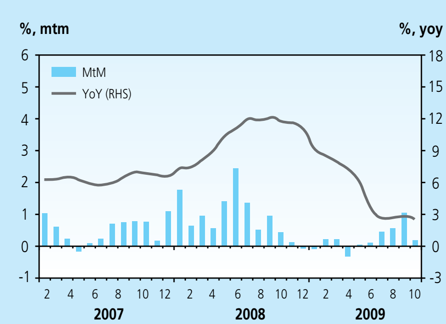



**Graph 2.10** Cement Consumption Growth

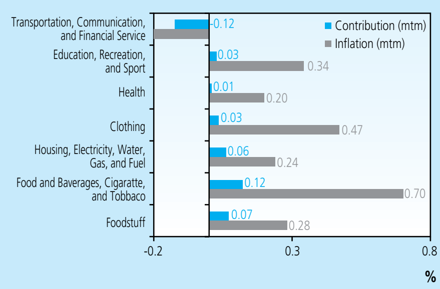
## Inflation

**Pressure in CPI inflation has subsided in the wake of the Eid-ul-Fitr festivities**. In October 2009, CPI inflation was recorded at 2.57% (yoy), down from 2.83% (yoy) one month earlier. On a monthly basis, inflation in October 2009 came to 0.19% (mtm), having dropped considerably from the previous monthly level of 1.05% (mtm). This is explained by the customary price corrections in the wake of the Eid-ul-Fitr festive season, with prices falling for key staple goods and some transport fares. In other developments, the October price hike for 12 kg bottled LPG and rise in toll road charges produced no significant impact on inflation in October 2009. In response to these developments, CPI inflation for the calendar year reached an estimated 2.48% (ytd).

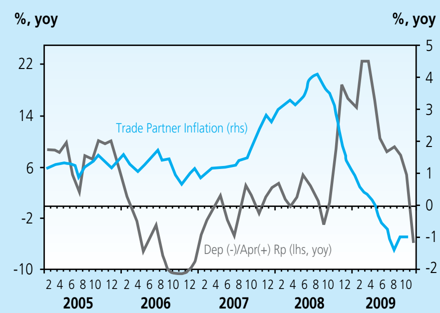
**Analysed by influencing factors, the decline in inflation is explained by fundamentals and non-fundamentals**. Fundamentals contributing to lower inflation were reflected in lower core inflation. In monthly terms, core inflation was uncharacteristically mild at 0.20% (mtm), well below the 0.80% (mtm) of the preceding month. Annual core inflation in October 2009 was recorded at 4.52% (yoy) following a decline from the previous month's level of 4.86% (yoy). The drop in core inflation is attributable to modest expectations of inflation and pressures from external factors, as expected from the appreciation in the rupiah amid mild pressure from imported inflation. Rising international gold bullion prices and jewellery



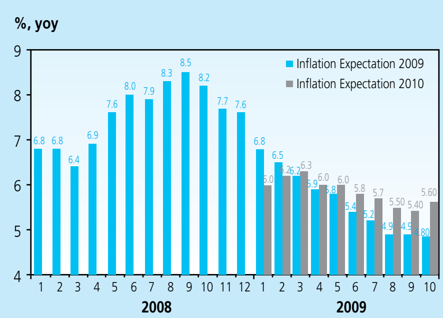

**Graph 2.11** Inflation




**Graph 2.12** Inflation by Category Goods and Services (%, mtm)




**Graph 2.13** Exchange Rate & Trade Partner Inflation




Source : Consensus Forecast

**Graph 2.14** Inflation Expectation from Consensus Forecast (CF)

prices contributed a thin 0.02% to inflation. In related developments, pressure from the output gap is estimated low, while supply side response is improving.

**Analysed by expenditure category, the fall in inflationary pressure is explained by reduced foodstuffs inflation and deflation in the transportation category**. Transportation contributed 0.12% deflation after having previously generated significant inflationary pressure at 0.16%. Key to this decline was the drop in fare surcharges levied during the festive season. Products contributing to deflation in the transportation category during October 2009 include intercity bus fares, air fares and rail fares. In the foodstuffs category, inflation was a slim 0.28%, having fallen from the preceding month's level of 2.43%.

**Administered prices recorded another month of deflation due to the minimum impact of price hikes for non-strategic items while some administered prices recorded decline**. The price cuts for subsidised fuels at end-2008 and early 2009 and the prevailing absence of hikes in administered prices has had significant deflationary impact in administered prices. In monthly figures, deflation in administered prices reached 0.1%. The administered prices deflation in October 2009 is explained primarily by an average 9% drop in prices for non-subsidised fuels (Pertamax, Pertamax Plus, etc.)[1] compared to the preceding month. Otherwise, the rise in bottled LPG prices and 15% hike in charges on 11 sections of toll roads announced on 28 September 2009 has had minimal impact on inflation. Taken together, administered prices recorded an estimated deflation of -6.01% (yoy).

**Annual volatile foods inflation reached 4.7%, less than the previous month's level of 4.98% (yoy)**. Volatile foods inflation remained below the normal trend (about 8%-9%) due to the effect of plentiful domestic market supply. On a monthly basis, volatile foods inflation came to 0.35% (mtm), down considerably from the previous monthly figure recorded at 2.67% (mtm). The softened pressure from volatile foods inflation is explained primarily by domestic factors in keeping with the seasonal trend following the Eid-ul-Fitr festivities. Prices mounted sharply only for red chilli peppers[2] due to adverse weather conditions that disrupted supply. In other developments, the surge in

1 On 15 October 2009, the state oil concern PT. Pertamina lowered its prices for non-subsidised fuels (Pertamax and Pertamax Plus) by an average of Rp 200-Rp 500 per litre.
2 Harvest failures in some regions (Central Sulawesi, North Sumatra, Ciamis).

foodstuffs inflation in response to the earthquake in West Sumatra has had minimal impact on inflation.

**Pressure from annual core inflation maintained a downward trend**. Core inflation during the month under review was recorded at 4.52% (yoy), having eased from 4.86% (yoy) one month earlier. Mild inflation expectations were key to this decline alongside continued minimum pressure from external factors. On the other hand, the increased supply-side response offset demand-side pressure, resulting in no significant impact on price components. Monthly core inflation in October reached 0.20% (mtm) down from the preceding month and the same period in past years.[3] Core inflation fell as a result of appreciation in the exchange rate, which is reported to have lowered prices for imports (including electronic goods).

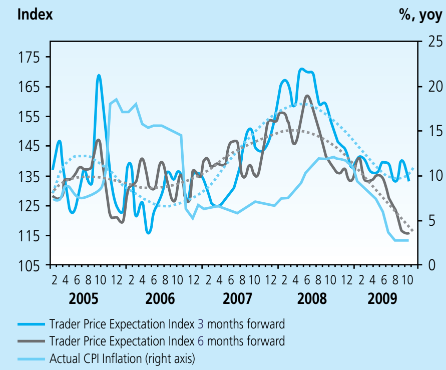
**Overall inflation expectations maintained a stable trend**. Results from the Consensus Forecast survey in October indicate expected inflation for 2009 to 4.8%, stable when compared to 4.9% one month before (Graph 2.14). Another survey involving traders also confirmed the relatively stable pattern in expected inflation 3 (three) months forward, while expected inflation 6 (six) months forward continue to show decline. Despite this, consumer surveys indicate rising inflation expectations. In survey findings, expectations of price increases at 6 months were related mainly to planned cuts in Government subsidies.

## Rupiah Exchange Rate

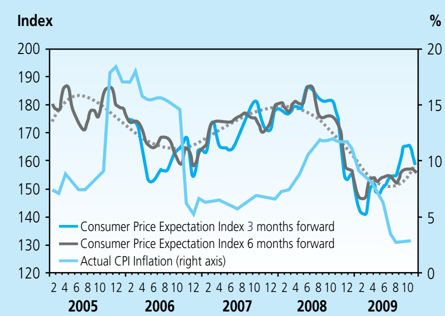
**The exchange rate maintained an appreciating trend in October 2009 accompanied by reduced volatility**. Averaged over the month, the rupiah gained 3.92% from Rp 9,489 to Rp 9,478 to the US dollar (Graph 2.17). At the end of the period, the rupiah closed 0.99% higher (ptp) at Rp 9,645 to the US dollar from the previous Rp 9,550. Although the rupiah charted significant appreciation, movement in the exchange rate was more stable with volatility narrowing to 0.89% from 0.99% in the preceding month (Graph 2.18).

**Support for rupiah appreciation in October 2009 came from favourable external and domestic conditions**. The more broad-

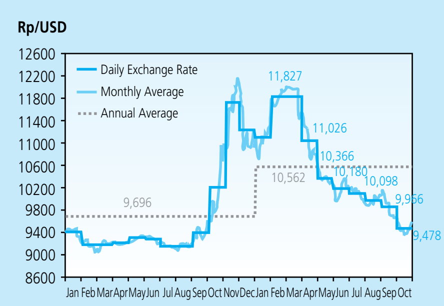
3 Averaging 0.5% in 2002-2007



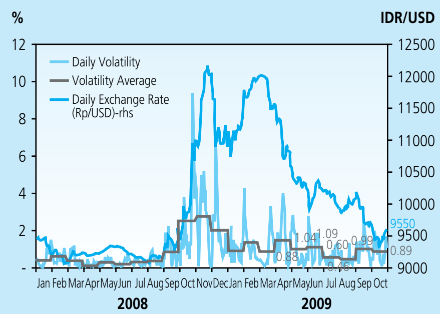

**Graph 2.15** SPE BI : BI Retail Sales Survey



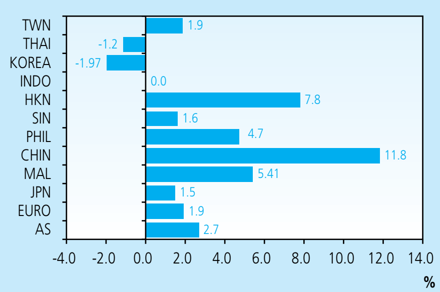

**Graph 2.16** Consumer Inflation Expectation - BI Consumer Survey



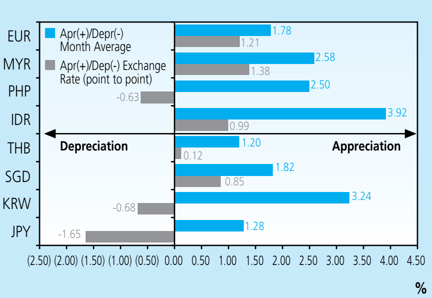

**Graph 2.17** Average Rupiah Exchange Rate




**Graph 2.18** Rupiah Exchange Rate Volatility




**Graph 2.19** Performance of Global Stock Markets




**Graph 2.20** Appreciation/Depreciation Exchange Rate Average October 2009 compare to September 2009

based improvement in economic conditions in multiple regions and solid condition of domestic fundamentals has strengthened investor risk appetite for Indonesia. The decision by the S&P rating agency to upgrade the credit outlook from "stable" to "positive" reflects the confidence of global investors in the credibility of Indonesian sovereign debt securities. With investors recovering their risk appetite, inflows have resumed into the domestic economy, adding to the supply of foreign exchange and ensuring equilibrium with overall domestic forex demand.

**Risk perceptions of investment in Indonesia remain generally favourable, underpinned by supportive domestic conditions and positive sentiment from external developments**. Conducive developments in the domestic economy and political conditions have helped sustain momentum in the improving perceptions of investment risk in Indonesia. The EMBIG spread is moving in a downward trend, having edged from 337 bps one month earlier to 333 bps. Despite this, external sentiment at the end of the period triggered a slight increase in risk factors. Indonesia's CDS widened from 183 bps in the preceding month to 191 bps (Graph 2.21). Movement in the swap premium indicator maintained a stable, declining trend, indicative of comparatively mild future pressure on the rupiah (Graph 2.22).

**Investment yields in rupiah are still favourably high when compared to other countries in Asia**. The higher yield spread on rupiah bonds in comparison to other Asian nations was again a key factor attracting foreign investors to Indonesia (Graph 2.23). No significant change has taken place in the interest rate differential, even though Bank Indonesia has held the policy rate at 6.5%. Uncovered Interest Rate Parity (UCIP) mounted only slightly from 6.45% one month earlier to 6.49%. However, Covered Interest Parity (CIP), representing the interest rate spread after factoring in risk, responded to deterioration in global risks at the end of the period by narrowing from 3.94% one month earlier to 3.69%.

# Monetary Policy

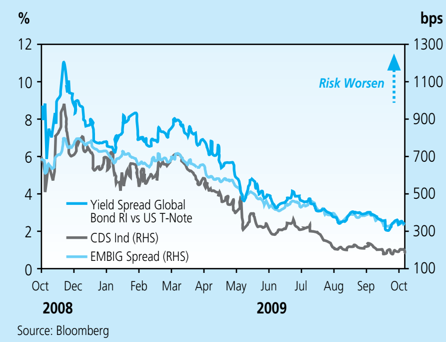
## *Interest Rates*

**The unchanged BI Rate in October 2009 was transmitted to the money market through improvement in interbank rates across various tenors in greater alignment with the BI Rate**. O/N interbank rates, reflecting the plentiful liquidity available to banks, continued to hover below the BI Rate. The weighted average O/N interbank rate came to 6.33%, or 17 bps under the BI Rate level. The spread between the average O/N interbank rate and BI Rate eased (Graph 2.24), consistent with intense efforts by BI to steer O/N rate movement closer to the BI Rate. This move is intended to reinforce BI policy signalling and ensure the credibility of the BI Rate in managing operational targets. In further developments, the spread also narrowed between the highest and lowest O/N interbank rates, indicating broader distribution of liquidity and reduced bank segmentation on the O/N interbank market. However, the average interbank rates for above O/N tenors were unchanged from one month before.

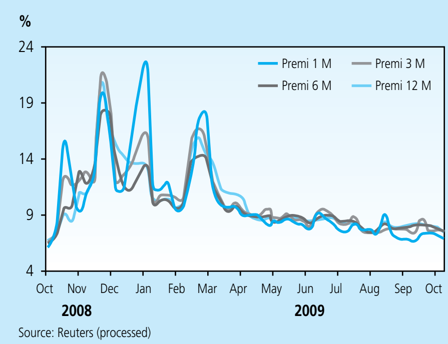
The adequate liquidity on the money market and subdued exchange rate movement have contributed to the formation of a level, stable structure in SBI rates across tenors. The weighted average 1-month SBI rate in outcome of the 28 October 2009 auction came to 6.49%, or 1 bps below the BI Rate. Added to this, spreads between the weighted average and rates in individual tenors reflected improved symmetry and stability, a development expected to signal banks to make further reductions in deposit and lending rates.

**Deposit rates came down by an even greater magnitude compared to the previous period**. In September 2009, the 1-month deposit rate fell 51 bps, more than one month before. As a result, the cumulative decline for 1-month deposit rates from December 2008 to September 2009 reached 297 bps. In similar movement, deposit rates in other tenors also moved lower, albeit in varying degrees. In analysis by bank category, the steepest decline in average deposit rates during September 2009 was recorded for state-owned banks at 43 bps, unlike previous months when foreign and joint venture banks were the most aggressive in lowering their deposit rates.

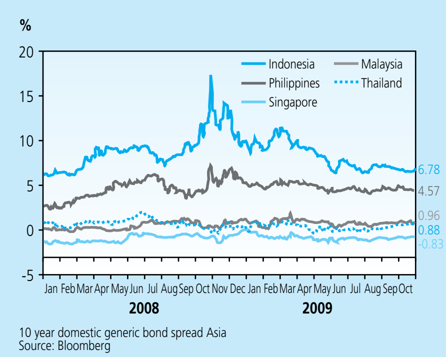
**With cost of funds in decline, response in loan interest rates has improved**. In analysis by purpose of use, lending rates came down



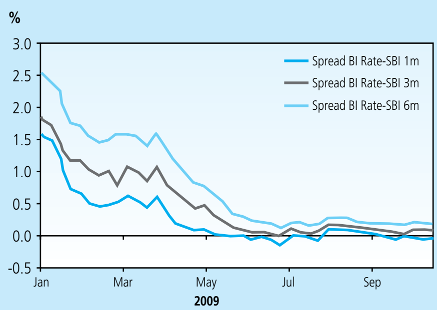

**Graph 2.21** Indonesia Risk Perception Indicator



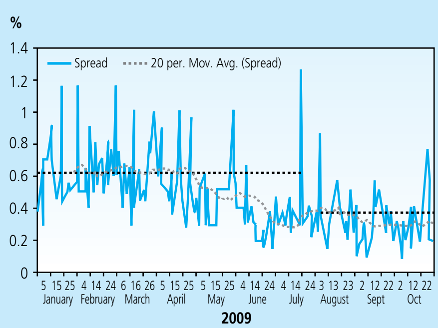

**Graph 2.22** Swap Premium




**Graph 2.23** Comparison of Some Regional Countries Yield Spread Government Bond




**Graph 2.24** Spread BI Rate vs SBI Rate




**Graph 2.25** Highest and Lowest O/N Interbank Rates

mainly for working capital credit (13 bps) and investment credit (18 bps). Consumption credit, on the other hand, moved 5 bps in the opposite direction, consistent with the relatively inelastic nature of this lending to interest rate movements. The weighted average rates for working capital credit and investment credit in September 2009 stood at 14.17% and 13.20%, down 13 bps and 18 bps from one month before. In contrast, consumption credit mounted to 16.67%. Taken together, the overall average decline for all lending rates in September 2009 came to 12 bps. In disaggregation by category of bank, the steepest decline in lending rates was again recorded at foreign and joint venture banks.

## *Funds, Credit and the Money Supply*

**Depositor funds were up in September 2009, albeit with growth tapering off due to the effect of government expenditures**. During September 2009, the depositor funds position widened by Rp 10.2 trillion. As a result of these changes, funding growth slowed to 16.0% (yoy) from 20.9% (yoy) one month earlier. The slowdown in funding growth in September 2009 resulted mainly from large-scale realisation of central government and regional government expenditures, visible in the reduced positions of government-related demand deposit accounts. Further drawing down was reported for demand deposit accounts held by private, non-financial companies and individuals, consistent with the seasonal trend after the Eid-ul-Fitr festivities. Depositor funds mounted in September 2009 mainly from a sharp rise in personal savings accounts, currently on an

**Table 2.1**
**Development of Various Interest Rates**

| Interest Rate (%) | 2008 | | | | 2009 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Sep | Oct | Nov | Dec | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep |
| BI Rate | 9.25 | 9.50 | 9.50 | 9.25 | 8.75 | 8.25 | 7.75 | 7.50 | 7.25 | 7.00 | 6.75 | 6.50 | 6.50 |
| Deposit Guarentee | 8.75 | 10.00 | 10.00 | 10.00 | 9.50 | 9.00 | 8.25 | 7.75 | 7.75 | 7.50 | 7.25 | 7.00 | 7.00 |
| 1-month Deposit (Weighted Average) | 9.26 | 10.14 | 10.40 | 10.75 | 10.52 | 9.88 | 9.42 | 9.04 | 8.77 | 8.52 | 8.31 | 7.94 | 7.43 |
| 1-month Deposit (Counter Rate) | 7.77 | 8.32 | 8.67 | 8.69 | 8.75 | 8.52 | 8.23 | 7.68 | 7.39 | 6.81 | 7.30 | 7.17 | 6.92 |
| Base Lending Rate | 13.29 | 13.65 | 14.07 | 14.16 | 14.18 | 13.98 | 13.94 | 13.78 | 13.64 | 13.40 | 13.20 | 13.00 | 12.96 |
| Working Capital Credit | 13.93 | 14.67 | 15.13 | 15.22 | 15.23 | 15.08 | 14.99 | 14.82 | 14.68 | 14.52 | 14.45 | 14.30 | 14.17 |
| Invesment Credit | 13.32 | 13.88 | 14.28 | 14.40 | 14.37 | 14.23 | 14.05 | 14.05 | 13.94 | 13.78 | 13.58 | 13.48 | 13.20 |
| Consumption Credit | 15.87 | 16.05 | 16.24 | 16.40 | 16.46 | 16.53 | 16.46 | 16.48 | 16.57 | 16.63 | 16.66 | 16.62 | 16.67 |

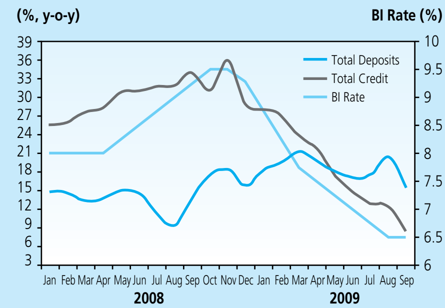
upward trend alongside decline in time deposit rates.  Renewed funding growth is predicted in rupiah deposits in coming months, mainly from the expansionary liquidity flows from the central government to the regions, alongside increased disbursements of bank lending.

**Credit expansion took a downturn, mirroring the change in depositor funds**. In September 2009, the outstanding credit position (including channelling) edged down by a thin Rp 481 million from the preceding month. This brings credit expansion for 2009 (January-September) to no more than Rp 46.2 trillion, equal to 3.4% (ytd) or 8.7% (yoy). Analysed by category of lending, the key factor in slow rate of credit growth is the steep correction in working capital credit. Despite this, lending recorded significant expansion in other categories, most importantly in consumption credit. Most affected by this drop in working capital credit is industry, one of the largest borrowers in the economy, as well as agriculture.

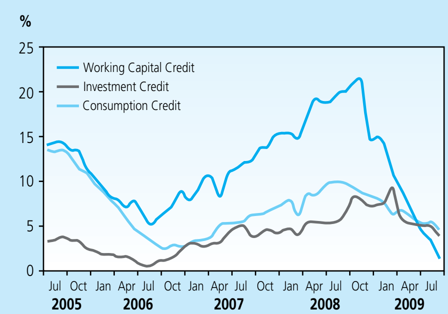
**Economic liquidity saw further contraction in September 2009, led by M1**. During the month, M1 came down by Rp 883 billion, while M2 and rupiah M2 widened by Rp 22.9 trillion and Rp 18.7 trillion in comparison to the preceding month. In response, economic liquidity, having picked up in August 2009, underwent renewed contraction in September 2009. Annual growth in M1, M2 and rupiah M2 reached 1.8%, 13.6% and 12.6%, down from the previous month's levels of 10.8%, 18.5% and 19.2%.

The slowing expansion in economic liquidity resulted in negative real growth in M1 and cash outside banks amid conditions of persistently low inflation, reflecting a lack of stability and strength in public purchasing power. The extent of economic liquidity not used by the public in economic activities is also reflected in M1 growth, which remains below the historical trend.

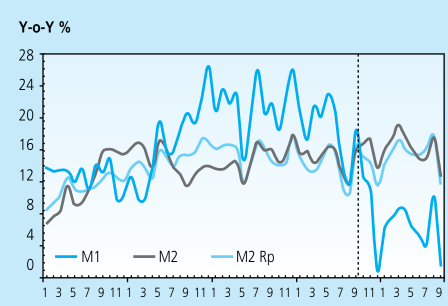
**The reduced growth in economic liquidity is attributable mainly to falling demand deposits**. This drop resulted mainly from lower positions in government-held accounts, including local government funds, indicating the commencement of more central and regional government projects. Personal demand deposits and time deposits held also contributed to the contraction in economic liquidity during September 2009, indicating a reliance of business on self-financing in addition to credit.



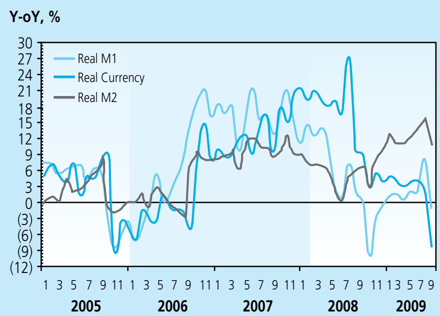

**Graph 2.26** Growth of Credit, Deposits, BI Rate



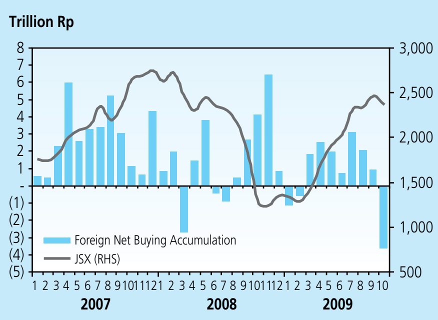

**Graph 2.27** Credit Growth Conribution by Type




**Graph 2.28** Growth of Currency in Circulation (Nominal)




**Graph 2.29** Growth of Currency in Circulation (Riil)




**Graph 2.30** Jakarta Composite Index (JSX) and Stock Foreign Net Buy/Sale

## *The Capital Market*

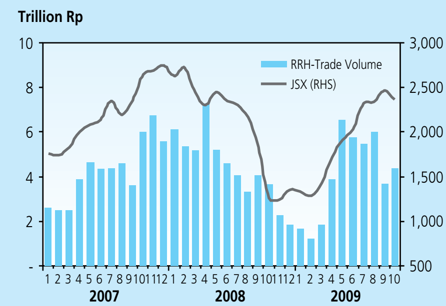
**The Jakarta Composite Index lost some ground in October 2009, despite maintaining a high level**. In October trading, the index closed the month in relatively high territory at 2,367.7 points. Following a sharp climb to past the 2,500 mark half-way through the period, the JSX Composite Index took correction to close at 4.05% below the previous month's position. In similar movement, market capitalisation slipped Rp 88 trillion from September 2009 to Rp 1,807 trillion. Despite this, the stock market averaged only Rp 4.44 trillion in daily trading in October, up slightly from the September average of Rp 3.71 trillion per day.

**The end of period downturn in the JSX Composite is explained by various global developments and the condition of issuing company fundamentals**. Preceding the sudden fall in the JSX Index was a global stock market downturn triggered by jitters over sustainability of global economic rebound and mixed signals from various US economic indicators over the ongoing economic recovery. Market actors responded with profit taking that sent prices tumbling on some global stock markets. In Indonesia, this was exacerbated by the poor condition assessed for fundamentals of some listed companies that triggered a rush among local and foreign investors to sell these stocks.

**Strong macro fundamentals failed to halt the JSX Index slide in October 2009**. The rush to sell came during a period of subdued inflation, initial downward movement in bank interest rates and comparative stability in the exchange rate. At the same time, foreign investors also engaged in portfolio rebalancing on stock markets in developing economies. During October, foreigners booked a net sale of Rp 3.12 trillion, following a steady run of net buying since March 2009. In addition, weaknesses visible in the microstructural condition of some listed companies prompted some market actors to offload shares. Financial statements released by some companies also indicated disappointing performance due to the high levels of financing required for capital expenditures.

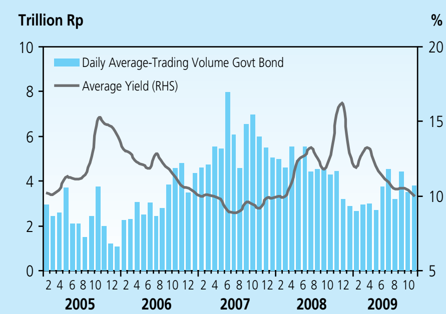
**At the sectoral level, the Jakarta Composite Index also weakened during October 2009**. Triggering this downturn were falling prices for mining, trading and estate stocks. The deteriorating performance in the mining sector in fact contrasts with the upward trend in international mining commodity prices. Similarly, the property and trade sectors recorded negative growth. Even so, positive growth was recorded in basic industries.

**The government securities market sustained some correction from global financial market turbulence**. Investors in these instruments engaged in profit taking that resulted in an increase in average yield. Average yield on Indonesian government securities widened 20 bps to 9.5% in October compared to the September level of 9.3%. Nevertheless, the dip in performance on the government securities market is predicted to be only temporary in view of the strong fundamentals of the domestic economy and the upgraded global market rating for Indonesian Government Bonds. Domestic investors showed continued interest in placing their funds in Indonesian government securities. More attractive yields on government securities and particularly Indonesian Retail Bonds (ORI) compared to time deposit interest were among the factors attracting investors to these fund placements.



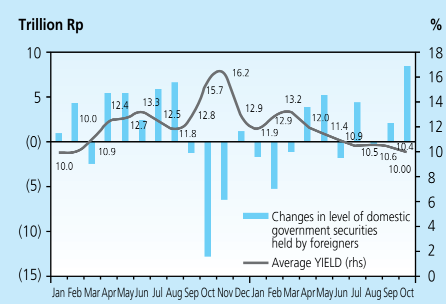

**Graph 2.31** Jakarta Composite Index (JSX) and Trade Value

**Foreigners again expanded their holdings on the Government Securities market**. The increased foreign ownership is explained by foreigner selling that took place only at the end of the period under review, and only for government securities in medium-term tenors. The leading foreign investors with increased placements in government securities were financial institutions and mutual funds. In response to these developments, the net foreign purchase of Indonesian government securities during October 2009 reached Rp 8.4 trillion, up from the September 2009 net foreign purchase recorded at Rp 2.1 trillion. This brought the overall foreign-held position in Indonesian government securities in October 2009 to Rp 100.9 trillion.



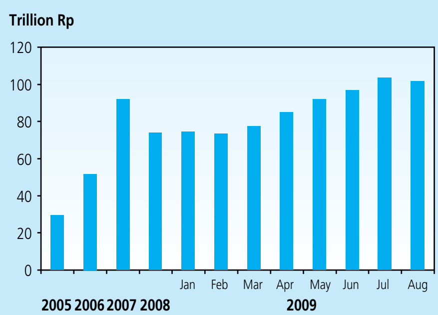

**Graph 2.32** Daily Average-Trading Volume Government Bond

**Trading conditions remained liquid on the government securities market**. Reflecting this was daily average trading volume at Rp 3.8 trillion, up slightly from the previous month's average of only Rp 3.5 trillion. The rise in trading volume was also matched by increased frequency of daily trading in government securities. During October 2009, government securities changed hands in an average of 323 transactions per day, compared to the September 2009 level of only 237 per day.




**Graph 2.33** Changes in level of domestic government securities held by foreigners

**On the mutual funds market, the decision to hold the BI Rate at 6.5%, the ongoing decline in bank deposit rates and stronger performance in underlying assets during Q3/2009 pushed NAV past the Rp 100 trillion mark**. Mutual fund managers responded to the still favourable condition of macroeconomic stability by releasing new mutual fund products, in so doing stimulated increased trading activity.




* August 7, 2009 position

**Graph 2.34** Mutual Funds

Mutual funds net asset value (NAV) mounted to Rp 101.68 trillion in early August 2009, up considerably from the beginning of the year when NAV was only Rp 75.82 trillion. The most important contributions to the increased NAV came from equity, fixed income and mixed funds. In early August, NAV in these three categories reached Rp 35.7 trillion, Rp 14.16 trillion and Rp 12.5 trillion. The present outlook for mutual funds remains upbeat, given the strengthening performance in underlying assets and further decline predicted in bank deposit rates.

## Condition of the Banking System

**Like before, the banking system is in overall solid condition**. Reflecting this is the resilient level of bank capital for absorbing risks, including credit risk, market risk and liquidity risk. In September 2009, the Capital Adequacy Ratio (CAR) was recorded at 17.7%, up from the August 2009 level of 17.0%. Improvement also took place in credit quality, with non-performing loans (NPLs) gross and net easing to 4.3% and 1.3% in September 2009 from the August 2009 positions of 4.5% and 1.5%. The resilience of the banking system was also evident in the ability to comply with the added statutory reserve requirement incorporating secondary reserves. Since the implementation of the new regulation on 24 October, no bank has reported difficulties in complying with this requirement.

**Table 2.2**
**Main Indicators of Banking System**

| Main Indicators | | 2008 | | | | 2009 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Sep | Oct | Nov | Dec | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep |
| Total Asset | (T Rp) | 2,122.6 | 2,235.0 | 2,303.4 | 2,310.6 | 2,307.1 | 2,344.9 | 2,352.1 | 2,327.4 | 2,309.8 | 2,354.3 | 2,331.4 | 2,384.6 | 2,388.6 |
| Deposits | (T Rp) | 1,601.4 | 1,674.2 | 1,707.9 | 1,753.3 | 1,745.6 | 1,767.1 | 1,786.2 | 1,780.9 | 1,783.6 | 1,824.3 | 1,806.6 | 1,847.0 | 1,857.3 |
| Credit | (T Rp) | 1,287.4 | 1,343.5 | 1,371.9 | 1,353.6 | 1,325.3 | 1,334.2 | 1,342.1 | 1,332.1 | 1,339.2 | 1,368.9 | 1,370.2 | 1,400.4 | 1,399.9 |
| LDR | (%) | 80.4 | 80.2 | 80.3 | 77.2 | 75.9 | 75.5 | 75.1 | 74.8 | 75.1 | 75.0 | 75.8 | 75.8 | 75.4 |
| NPLs Gross* | (%) | 3.9 | 3.9 | 4.0 | 3.8 | 4.2 | 4.3 | 4.5 | 4.6 | 4.7 | 4.5 | 4.6 | 4.5 | 4.3 |
| NPLs Net * | (%) | 1.4 | 1.6 | 1.5 | 1.5 | 1.6 | 1.6 | 1.9 | 2.0 | 1.9 | 1.7 | 1.7 | 1.5 | 1.3 |
| CAR | (%) | 16.5 | 16.0 | 16.3 | 16.2 | 17.6 | 17.7 | 17.4 | 17.6 | 17.3 | 17.0 | 17.0 | 17.0 | 17.7 |
| NIM | (%) | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.3 | 0.6 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.4 |
| ROA | (%) | 2.6 | 2.7 | 2.6 | 2.3 | 2.7 | 2.6 | 2.8 | 2.7 | 2.7 | 2.7 | 2.7 | 2.7 | 2.6 |

* with channeling

**Bank profitability remains strong, despite slowing credit expansion**. Healthy profitability is evident in relatively high return on assets (ROA) in September 2009 at 2.6%. Added to this is the robust net interest margin (NIM) for the banking system. So far in 2009, the NIM has held relatively stable in the 5.3%-5.5% range. Banks have responded to the downward BI Rate trend with steeper cuts in deposit rates compared to lending rates, producing a widening in the spread. This is one factor enabling banks to maintain high profitability amid slowing lending performance. However, with credit expansion lagging behind growth in depositor funds, margins have been comparatively stable.

## III. MONETARY POLICY RESPONSE

In the opinion of the Board of Governors Meeting, the 6.5% level in the BI Rate remains consistent with achievement of the 2010 inflation target set at 5% ± 1%. This direction in monetary policy is also regarded conducive to the economic recovery process and banking intermediation. For these reasons, the Bank Indonesia Board of Governors' Meeting convened on 4 November 2009 decided to keep the BI Rate unchanged at 6.5%.

# Latest Indicators

| FINANCIAL SECTOR | 2008 | | | | 2009 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Sep | Oct | Nov | Dec | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep |
| **INTEREST RATE & STOCK** | | | | | | | | | | | | | |
| One month SBI 1) | 9.71 | 10.98 | 11.24 | 10.83 | 9.50 | 8.74 | 8.21 | 7.59 | 7.25 | 6.95 | 6.71 | 6.58 | 6.48 |
| Three month SBI 1) | 9.91 | 11.16 | 11.50 | 11.08 | 9.93 | 9.25 | 8.61 | 7.95 | 7.39 | 7.05 | 6.79 | 6.63 | 6.55 |
| One month Deposit 2) | 9.26 | 10.14 | 10.40 | 10.75 | 10.52 | 9.89 | 9.42 | 9.04 | 8.77 | 8.52 | 8.31 | 7.94 | - |
| Three month Deposit 2) | 9.45 | 10.17 | 10.83 | 11.16 | 11.34 | 11.13 | 10.65 | 10.09 | 9.68 | 9.25 | 8.99 | 8.73 | - |
| One week JIBOR 2) | 9.69 | 10.27 | 10.34 | 10.01 | 9.43 | 8.71 | 8.30 | 8.03 | 7.69 | 7.09 | 6.96 | 6.56 | 6.46 |
| JSX Indices 3) | 1,833 | 1,257 | 1,242 | 1,355 | 1,333 | 1,285 | 1,434 | 1,723 | 1,917 | 2,027 | 2,323 | 2,342 | 2,468 |
| **MONETARY AGGREGATES (billions Rp)** | | | | | | | | | | | | | |
| **Base Money** | 392,136 | 307,460 | 306,773 | 344,688 | 314,662 | 303,777 | 304,718 | 308,277 | 309,232 | 322,994 | 322,850 | 324,663 | 354,297 |
| **M1(C+D)** | 491,729 | 471,354 | 475,053 | 466,379 | 447,626 | 444,035 | 458,580 | 465,788 | 465,726 | 493,384 | 479,518 | 501,525 | 503,869 |
| Currency (C) | 223,166 | 190,888 | 195,032 | 209,378 | 191,339 | 186,611 | 186,538 | 191,194 | 192,143 | 203,838 | 201,172 | 200,871 | 210,810 |
| Demand Deposit (D) | 268,563 | 280,466 | 280,021 | 257,001 | 256,288 | 257,424 | 272,043 | 274,594 | 273,584 | 289,546 | 278,346 | 300,654 | 293,059 |
| **Broad Money (M2 = C+D+T)** | 1,768,250 | 1,802,932 | 1,841,163 | 1,883,851 | 1,862,984 | 1,890,430 | 1,909,681 | 1,906,341 | 1,915,083 | 1,967,776 | 1,951,155 | 1,984,946 | 1,992,047 |
| Quasi Money (T) | 1,276,521 | 1,331,578 | 1,366,110 | 1,417,472 | 1,415,358 | 1,446,395 | 1,451,100 | 1,440,553 | 1,449,357 | 1,474,392 | 1,471,637 | 1,483,421 | 1,488,178 |
| Quasi Money (Rupiah) | 1,033,846 | 1,050,558 | 1,069,619 | 1,136,979 | 1,133,335 | 1,147,996 | 1,152,121 | 1,155,391 | 1,166,032 | 1,193,263 | 1,192,040 | 1,197,275 | 1,200,352 |
| Time Deposit | 594,839 | 608,747 | 622,849 | 662,629 | 674,899 | 691,768 | 695,279 | 694,017 | 702,949 | 714,097 | 712,829 | 715,050 | 706,126 |
| Saving Deposit | 439,008 | 441,811 | 446,770 | 474,350 | 458,435 | 456,228 | 456,842 | 461,374 | 463,083 | 479,166 | 479,211 | 482,224 | 494,226 |
| Foreign Currency Deposit | 242,674 | 281,020 | 296,490 | 280,493 | 282,023 | 298,399 | 298,979 | 285,162 | 283,325 | 281,129 | 279,597 | 286,146 | 287,826 |
| Broad Money Rupiah | 1,525,575 | 1,521,912 | 1,544,673 | 1,603,358 | 1,580,961 | 1,592,031 | 1,610,702 | 1,621,179 | 1,631,758 | 1,686,647 | 1,671,558 | 1,698,800 | 1,704,221 |
| **Claim on Business Sector** | 1,286,682 | 1,337,099 | 1,366,089 | 1,348,827 | 1,331,559 | 1,345,369 | 1,350,570 | 1,343,846 | 1,350,587 | 1,380,575 | 1,387,416 | 1,417,927 | 1,410,934 |
| **Credit by DMBs** | 1,239,501 | 1,289,412 | 1,315,728 | 1,300,179 | 1,281,772 | 1,293,069 | 1,297,288 | 1,290,022 | 1,297,955 | 1,327,462 | 1,331,188 | 1,358,757 | 1,351,302 |
| **PRICES** | | | | | | | | | | | | | |
| CPI - monthly (%, mtm) | 0.97 | 0.45 | 0.12 | -0.04 | -0.07 | 0.21 | 0.22 | -0.31 | 0.04 | 0.11 | 0.45 | 0.56 | 1.05 |
| CPI - 1 year (%, yoy) | 12.14 | 11.77 | 11.68 | 11.06 | 9.17 | 8.60 | 7.92 | 7.31 | 6.04 | 3.65 | 2.71 | 2.75 | 2.83 |
| **EXTERNAL SECTOR** | | | | | | | | | | | | | |
| Rp/USD (endperiod,midrate) | 9,378 | 10,995 | 12,151 | 10,950 | 11,355 | 11,980 | 11,575 | 10,713 | 10,340 | 10,225 | 9,920 | 10,060 | 9,681 |
| Non oil/gas Export (f.o.b, million USD) 4) | 10,181 | 9,325 | 8,086 | 7,394 | 6,345 | 6,713 | 7,473 | 7,053 | 8,229 | 8,470 | 8,198 | 8,848 | - |
| Non oil/gas Import (c$f, million USD) 4) | 8,770 | 9,688 | 7,553 | 7,396 | 5,706 | 5,008 | 5,819 | 5,488 | 6,366 | 6,442 | 7,193 | 7,073 | - |
| Net International Reserve (million USD) | 50.85 | 47.61 | 47.48 | 48.39 | 47.96 | 47.17 | 50.68 | 51.72 | 51.65 | 50.99 | 50.72 | 50.84 | 53.81 |

| QUARTERLY INDICATOR | 2009 | |
|---|---|---|
| | Q.I | Q.II |
| **Real GDP Growth (% y-o-y)** | 4.44 | 3.99 |
| Consumption | 7.28 | 6.27 |
| Investment | -0.85 | 2.63 |
| Changes in Stocks | -143.87 | -1.33 |
| Export | -18.73 | -15.66 |
| Import | -26.03 | -23.89 |
| Incremental Capital Output Ratio (ICOR, %) | | |
| External Debt Outstanding (millions of USD) | | |

* Provisional Figures
* Using 2000 base year (BPS-Statistic Indonesia)
1) end of week
2) weighted average
3) end period closing
4) closed file
Sources : Bank Indonesia, except stock market data (BAPEPAM), CPI, export/import and GDP (BPS)