



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

January 2010

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	<i>Deputi Gubernur Senior</i>
Hartadi A. Sarwono	<i>Deputi Gubernur</i>
Siti Ch. Fadrijah	<i>Deputi Gubernur</i>
S. Budi Rochadi	<i>Deputi Gubernur</i>
Muliaman D. Hadad	<i>Deputi Gubernur</i>
Ardhayadi Mitroatmodjo	<i>Deputi Gubernur</i>
Budi Mulya	<i>Deputi Gubernur</i>



Table of Contents

I. Monetary Policy Statement	3
II. The Economy and Monetary Policy	6
Developments in the World Economy.....	7
Economy Growth in Indonesia	9
Inflation.....	12
Rupiah Exchange Rate	14
Monetary Policy	16
Interest Rates.....	16
Funds, Credit, and the Money Supply	18
The Stock Market	19
The Government Securities Market	20
Mutual Funds Market	21
Condition of the Banking System.....	21
III. Monetary Policy Response	22

I. MONETARY POLICY STATEMENT

As 2009 drew to a close, various economic indicators pointed to ongoing improvement in macroeconomic conditions in Indonesia.

Supporting this was rising optimism for domestic and global growth and prudently managed domestic macroeconomic stability. Growth in 2009 reached an estimated 4.3% with inflation at 2.78%, a balance of payments surplus and exchange rate appreciation measured point-to-point at 15.65% over the preceding year. Within the context of the global crisis, these positive achievements were closely tied to resilient domestic demand, a sound and stable banking system, mounting optimism in expectations for global economic recovery and the accommodative fiscal and monetary policy response that has shored up the domestic economy.

The overall condition of the global economy and financial markets has followed a positive trend. In developed countries, the economic recovery process is moving forward.

This is borne out in the strengthening performance in consumption and production and turnaround in the labour market. Labour market conditions in the US and Japan are improving in line with expanding consumption and production. The economies of Asia, which are gaining importance as engines of global economic recovery, are also charting more robust growth. In a similar vein, performance on global financial markets is on the rise. Although investor confidence was shaken during the Dubai World debt crisis and Greek fiscal crisis, impact was short-lived with comparatively little knock-on effect on world financial markets. In preliminary figures, global inflation resumed upward movement in response to the ongoing recovery in the world economy, while remaining below inflation levels reached in 2008. This turnaround has enabled some advanced economies to maintain an accommodative monetary policy stance. Most central banks in advanced nations, such as the USA, UK and Japan, kept their rates on hold during December in an effort to boost economic recovery.

At home, the improvement in the global economy has strengthened exports and investment.

Following a steep decline in the first half of 2009, exports began recovering mid-year in keeping with the progressive improvement in global economic recovery and mounting commodity prices. Estimates show that export-oriented sectors such as manufacturing performed more strongly in Q4/2009 in response to rising external

demand. At home, household consumption has maintained brisk growth, bolstered by stable public purchasing power and sustained levels of consumer confidence. The resurgence in exports and sustained high levels of consumption have strengthened business optimism for investment, particularly since mid-2009. The investment growth projection for Q4/2009 is upbeat, reflected among others in increased cement consumption and renewed growth in capital goods imports. After factoring these improvements in economic conditions, the annual rate of economic growth for Q4/2009 in preliminary figures is 4.4%. Economic growth for 2009 as a whole is estimated at 4.3%.

Domestic economic resilience has been coupled with reductions in inflationary pressure. December inflation reached only 0.33% (mtm), well below the historical average. Measured annually, CPI inflation in 2009 came to 2.78% (yoy) while core inflation was recorded at 4.28% (yoy). The low inflation outcome is closely linked to external demand and a series of policy actions instituted by the government. The steep global economic contraction sent world commodity prices tumbling in 2009, a development that also slowed activity in the domestic economy. Besides the influence of external developments, low inflation was also attributable to the appreciating trend in the rupiah during 2009. Brisk capital inflows on domestic financial markets helped to boost the value of the rupiah, with the effect most noticeable after the end of Q1/2009. In added developments, the subdued inflation in 2009 was closely linked to a series of government policy actions. Falling prices for crude oil and other international commodities afforded the government additional room for a renewed cut in subsidised fuel prices early in the year. At the same time, government efforts to safeguard the supply and distribution of food commodities, led by rice, resulted in significantly low volatile foods inflation compared to historical levels. In response to these developments, inflation came below the 2009 inflation target set at 4.5%±1%.

The balance of payments posted a surplus, contributing to the appreciation in the rupiah. During 2009, the surplus in Indonesia's balance of payments boosted international reserves to USD66.1 billion, equivalent to 6.6 months of imports and servicing of official external debt. The balance of payments surplus is explained primarily by the significant drop in imports in line with the reduced demand from export-oriented industry for imported raw materials and also lower imports of consumer goods. While exports recorded negative growth, performance was still ahead of imports. Driving this was the growing demand for resource-based

commodities from the emerging markets of Asia, which have mounted a more rapid recovery. Added support for the balance of payments surplus came from heavy capital inflows stimulated by the improvement in the macroeconomic outlook, high yields on rupiah placements and strengthening international confidence in the domestic corporate sector. Bolstered by the balance of payments, the rupiah exchange rate maintained an upward trend from the end of Q1/2009. Point to point, the rupiah appreciated 15.65% over end-2008 to Rp 9,425 to the USD.

In the financial sector, stability was maintained in the banking system. However, lending rates did not ease as expected. Bank deposit rates, on the other hand, maintained their downward movement. Even so, monetary policy transmission through the interest rate channel was reflected in the still limited reduction in loan interest rates. In response to the lack of significant cuts in loan interest rates, slow take up in economic activity and persistently strong perceptions of risk held by the banking system, bank lending saw only modest expansion from January to November 2009 at 5.7% (ytd). In the asset price channel, the loose bias policy stance met with favourable response on the stock market and government securities market. The stock index soared on the back of heavy capital inflows and positive developments on the global financial market. On the bond market, government securities yield narrowed in keeping with optimism for world economic recovery and improving global perceptions of risk in Indonesia, in addition to the comfortable levels of inflation and fiscal sustainability. On the micro level, national banking system remains in stable condition, as indicated by the robust capital adequacy ratio (CAR) at 17% in November 2009. At the same time, the gross non-performing loans (NPLs) ratio was kept to 4.4% with net NPLs at 1.4%. Banking liquidity, including liquidity on the interbank money market, has shown further improvement alongside growth in depositor funds.

Looking forward, the outlook is for further improvement in the Indonesian economy, although various risks and uncertainties call for vigilance. Bank Indonesia forecasts economic growth to reach 5.0%-5.5% in 2010 while inflation is targeted in the range of $5\pm 1\%$. Actions to boost economic growth momentum while maintaining low inflation remain daunted by various micro and structural challenges in the economy, such as weak manufacturing competitiveness, oligopolistic tendencies in market structures for food commodities and various problems related to locations of centres for production, distribution and trade. The challenges

posed by the lack of optimum monetary policy transmission through the credit channel are a priority area calling for immediate resolution.

In view of these problems and challenges, the Bank Indonesia monetary policy for achieving the 5±1% inflation target in 2010 will be backed by a series of policy actions. In operational terms, policy will focus on strengthening the effectiveness of monetary policy transmission, managing excess banking liquidity and curbing exchange rate volatility in order to manage public expectations of inflation. At the structural level, stronger coordination is envisaged with the Government to mitigate structural impact from inflation caused by problems with distribution, trading systems and market structures for staple commodities. The effectiveness of the Inflation Control Team, an interministerial body responsible for inflation control, will be enhanced at the central government and regional levels.

On 6 January 2010, the Bank Indonesia Board of Governors Meeting decided to hold the BI Rate at 6.5%. Like before, the interest rate corridor is set at about +/-50 bps of the BI Rate, with the repo rate at 7% and the short-term deposit facility (FASBI) at 6%. In the key decisions underlying this decision, the BI Rate level remains consistent with the 5% ±1% inflation target for 2010 and the present monetary policy stance is also regarded conducive to the economic recovery process and the operation of the bank intermediation function.

II. THE ECONOMY AND MONETARY POLICY

The Indonesian economy has shown steady improvement in keeping with the upbeat trend in global economic and financial market conditions. Concerning prices, inflation was kept remarkably low throughout 2009 in comparison to the preceding year, due mainly to pressure from non-fundamentals. At the same time, the loose bias monetary policy in 2009 provided a boost to asset prices, including the JSX Composite Index (JCI).

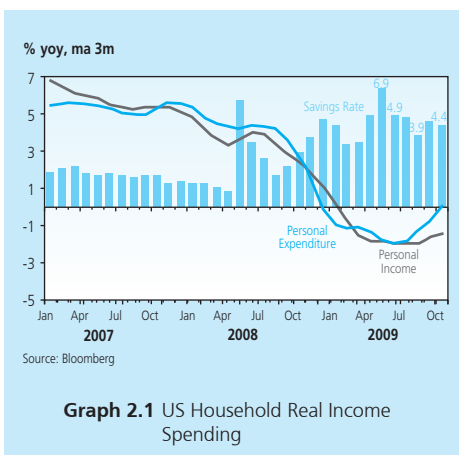
On the micro level, conditions in the national banking system remain stable.

Developments in the World Economy

Overall conditions in the world economy and global financial markets have seen steady improvement. In developed countries, the economic recovery process forges ahead as demonstrated by the more robust performance in consumption and production and the general signs of initial gains in labour market conditions. The economies of Asia have a vital role as the locomotives of global economic recovery. Domestic demand is charting more solid growth in Asia, buoyed by fiscal stimuli amid improvement in external conditions. The buoyant recovery in Asian economies has prompted further gains in financial market indicators, led by share prices. China, which provides the driving force for economies in Asia, is recovering quickly. The rapid pace of economic growth in China has stimulated inflows of foreign capital while imports grow at a faster rate than exports. This upward trend in external performance alongside renewed consumption has enabled Asia's economies to recover more quickly than other regions.

Economies in advanced nations continue to march towards recovery. Household expenditures received a boost from the festive seasons of Thanksgiving in the USA and Silver Week in Japan, producing gains in the retail sales indicators for both nations. Labour market conditions in both nations have also improved in line with expanding consumption and production. However, conditions of labour markets in Europe have worsened, resulting in diminished household incomes. The fading effect of the fiscal stimuli in the US and Japan has prompted the governments of the two nations to plan a second phase fiscal stimulus package. This is expected to provide an added boost for further recovery.

The US economy is on the mend, buoyed by stronger consumption and the improving condition of the labour market. US household consumption is rising, as demonstrated primarily by US retail indicators bolstered among others by the cash for clunkers programme (Graph 2.1). The US government has set aside 1 billion dollars to pay up to 4,000 dollars per vehicle to buyers trading in gas guzzlers for more fuel-efficient models. This programme has boosted car sales and fuelled strengthening consumer confidence in the future outlook for the economy. Recovery in the US economy is also reflected in less pressure from job losses, with unemployment down from 10.2% in October to 10.0% in November. Even so, the still high rate of unemployment has prompted the US government to launch a second fiscal stimulus package projected to



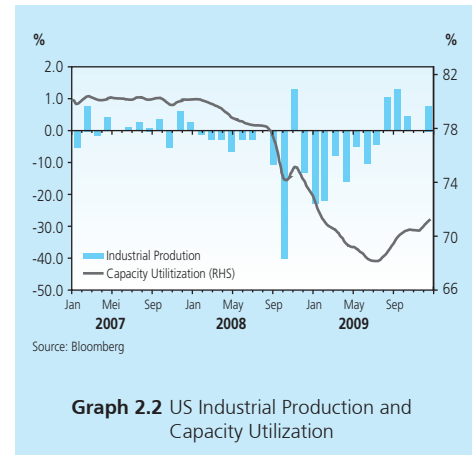
Graph 2.1 US Household Real Income Spending

reach USD150 billion. The second package will be financed from unused funds for the Troubled Assets Relief Programme (TARP), most importantly elements of the Capital Purchase Programme (CPP) not appropriated due to the improved condition of banking capital.

Production sectors have begun to climb in the USA. Business has responded to expectations of rising consumption in the USA by taking on added inventories in production sectors. Inventories were expanded to anticipate surging household consumption near the end of the year. The improving fortunes of the US manufacturing sector are reflected in gains in production indices and production capacity (Graph 2.2). Despite this, the Purchasing Manager Index (PMI) weakened slightly in November over fears that the fiscal stimulus would lose steam. Looking forward, production sectors are forecasted to gather overall momentum.

The downward trend in the US dollar and keen risk appetite among investors has led to steady gains on global financial markets. Global financial markets are reporting better performance, despite renewed pressure from loss of investor confidence triggered by the Dubai World debt crisis and the fiscal crisis in Greece. However, the impact of the twin crises proved short-lived with minimum knock-on effects on world financial markets. Upbeat activity on global stock markets is indicated by the MCSI composite index. Global liquidity conditions have also improved, as illustrated by the narrowing of the LIBOR to Overnight Index Swap (OIS) spread in response to the unconventional measures adopted by central banks in the USA, Eurozone, Japan and the UK. In a similar vein, subdued investor perceptions of risk and the improving economic outlook prompted outflows from US Treasuries to higher-risk assets such as stocks, corporate securities and emerging market assets. Financial markets in Asia are also up on the strength of Asia's improving economic fundamentals.

World inflation in 2009 is estimated similar to one month earlier, due to the effects of the ongoing recovery in the world economy. The December estimate for global inflation for 2009 is about the same as for the preceding month at 1.73% (yoy) in response to mounting world economic activity and international commodity prices. Nevertheless, the inflation estimate is below the average inflation for the preceding year, recorded at 6.0%. Inflationary pressure in developing nations is estimated at 3.98% (yoy), while in advanced economies the inflation estimate is only 0.04% (yoy).

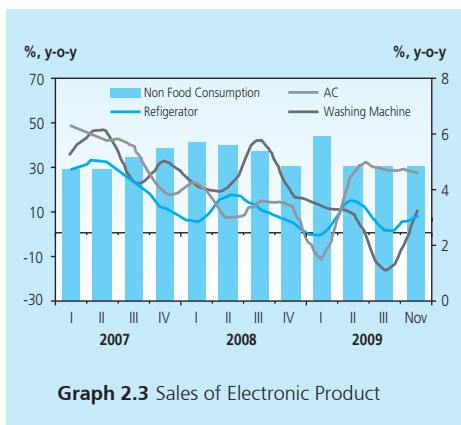


Graph 2.2 US Industrial Production and Capacity Utilization

The policy rates in most advanced nations reflect an accommodating stance. Most central banks in developed economies, such as the USA, UK, Japan, Canada, New Zealand, Sweden and Switzerland, held their rates low in December in moves to boost economic recovery. However, the Reserve Bank of Australia (RBA) opted for further monetary tightening in a third increase in the policy rate this year, taking it to 3.75%. The goal of this tightened stance is to prevent the emergence of an asset bubble and fend off the likelihood of mounting inflationary pressure in Australia. The monetary policy response in emerging markets, particularly in Asia, is unchanged, although some Latin American nations have switched to a more accommodative stance. Looking at the year as a whole, monetary policy instituted by central banks in developed and developing nations has maintained a loose bias with low levels of rates. The relaxed monetary policy stance has been pursued in efforts to ease pressures on financial markets and prevent further collapse in domestic demand.

Economic Growth in Indonesia

In 2009, the Indonesian economy grew by an estimated 4.3% (yoy). During the first half of the year, pressures from falling global demand since the beginning of the year sapped growth in exports and investment. The weak export and investment growth resulted in loss of public purchasing power and set of a round of job losses. Nevertheless, the round of activities related to the national elections and various government measures to strengthen public purchasing power by means of the direct cash transfers programme and income tax relief have boosted household consumption levels. Taken together for the first half of 2009, household consumption expanded at 6.0% in Q1/2009 and 4.8% in Q2/2009. Despite slowing from the preceding quarter, household consumption continued to forge ahead at a brisk pace. In the second half of 2009, household consumption maintained fairly stable growth at 4.7% even though the elections were over. Driving this was the continued high consumption by middle and upper class consumers, payment of the 13th month salary and the seasonal rise in consumption preceding religious festivities. Additionally, rising exports are also estimated to have bolstered consumption levels during the second half of 2009. **On the supply side, the world economic slowdown has impacted performance**



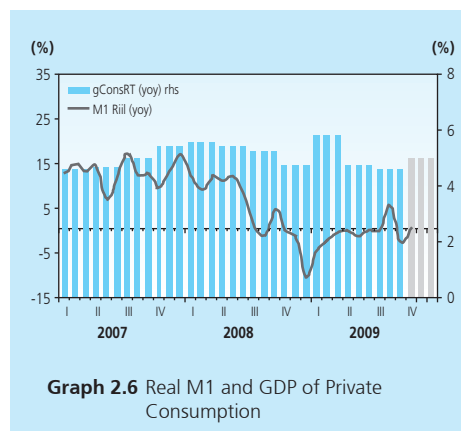
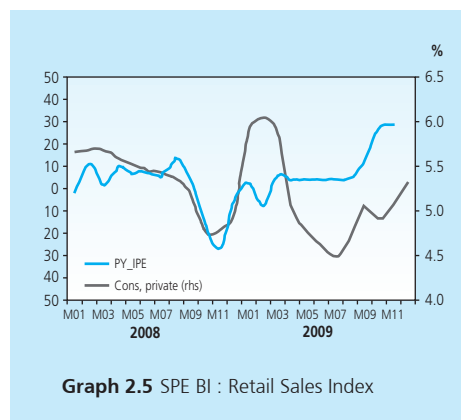
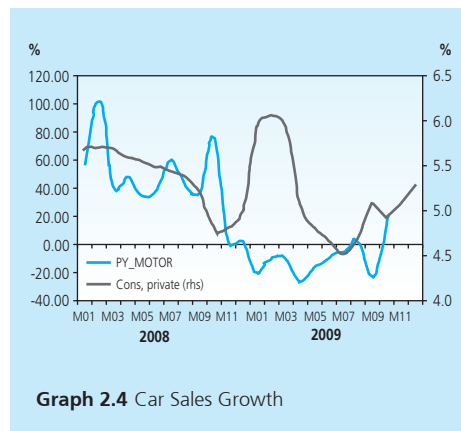
Graph 2.3 Sales of Electronic Product

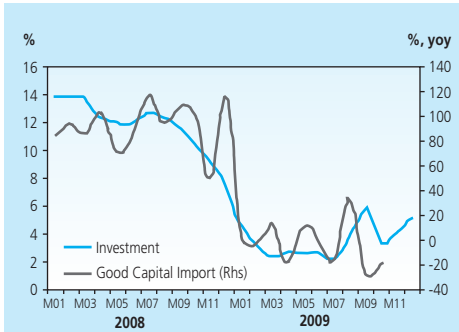
in tradable sectors, while non-tradable sectors continued to forge ahead. The world economic slowdown has had minimum impact on the agriculture and trade sectors, but has significantly borne down on manufacturing performance due to falling demand for exports in trading partner nations. The organisation of the legislative elections and presidential polls in the first half of 2009 stimulated activity in non-tradable sectors and manufacturing, led by the food and beverages, textiles and paper subsectors. Alongside this, the fast-paced growth in transport and communications during 2009 was driven primarily by performance in the communications subsector.

Indonesia's economic growth in Q4/2009 is estimated higher in line with the ongoing improvement in global and domestic economic conditions. On the demand side, estimates for household consumption remain high, bolstered by stable public purchasing power and sustained levels of consumer confidence. This will ultimately fuel business optimism for investment. Exports are projected higher on the back of the ongoing improvement in the global economy and mounting commodity prices. On the supply-side, some sectors show signs of improvement in response to stronger external demand and the stable condition of the domestic economy.

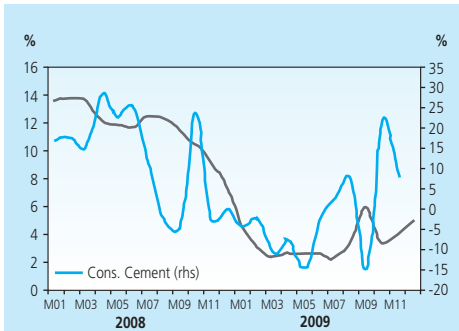
Household consumption maintained comparatively robust growth in estimates for Q4/2009. This is consistent with the upward movement in leading indicators for household consumption. The boost from seasonal factors towards the end of the year and rising export revenues is thought to have maintained stable household consumption growth during Q4/2009. Further support for this came from developments in a number of leading indicators. Public purchasing power for consumption of durables, such as electronics and motor vehicles, improved at a faster rate in October 2009 (Graphs 2.3 and 2.4). The retail index also mounted more vigorously in mid-Q4/2009, buoyed by higher sales in the clothing and accessories, construction materials and food and tobacco categories (Graph 2.5). In similar developments, growth in consumer goods imports early in Q4/2009 provided added confirmation of stable levels of private consumption. The rising consumption is also reflected in more vigorous real M1 growth as of October 2009 (Graph 2.6).

Investment (gross fixed capital formation) charted higher estimated growth in Q4/2009 in line with strengthening external and domestic demand. The renewed growth in capital goods

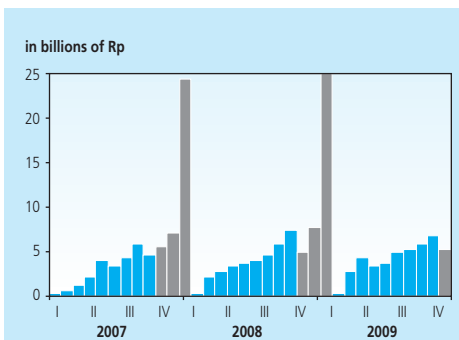




Graph 2.7 Capital Goods Import and Gross Fixed Capital Formation



Graph 2.8 Cement Consumption Growth



Graph 2.9 Government Capital Expenditure

imports, brisk cement consumption and expectations of the year-end surge in Government capital expenditures support indications of more upbeat investment growth in Q4/2009 (Graphs 2.7, 2.8 and 2.9). In disaggregation by structure, projected figures again suggest that construction provided the major source of the quarter’s investment growth. In regard to financing, adequate support is available from investment financing, as demonstrated in the brisk level of real investment credit expansion (Graph 2.10).

With conditions improving in trading partner economies, exports are estimated to have mounted higher in Q4/2009.

Indications of stronger export performance are reflected in the growing demand from advanced nations such as the United States, as well as China. Furthermore, the gains in production indices, consumer confidence indices and business sentiment in Europe and China have given added boost to export growth. Indications of improvement were also reflected in high volume of global trade as demonstrated in the Baltic Dry index for December 2009. Similarly, trade with other nations such as India is also expected to improve following the conclusion of the ASEAN-India Free Trade Agreement (AI-FTA). In the export financing area, the launching 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. In analysis by sector and commodity group, non-oil and gas export growth continues to rely heavily on primary commodities, led by mining products such as coal and industrial products such as palm oil.

Imports growth is estimated higher in Q4/2009 in response to mounting domestic and external demand.

The added import growth momentum is understood to be driven by rising household consumption and demand for raw materials and capital goods to support production, mainly in the manufacturing sector. Sustained improvement in import growth is also confirmed by increased collection of import duties that reflect more rapid growth in the value of imports. The most important contribution to import growth comes from accelerated growth in imports of raw materials and intermediate inputs. Like before, import growth in January-October 2009 was dominated by imports of capital goods required for production activities, such as machinery, mechanical tools and electrical equipment. In response to these developments and buoyed by conducive trends in the global economy, Indonesia’s balance of payments again charted a surplus.

Sectoral performance is also estimated higher in Q4/2009 from the effect of stronger external demand and stable demand at home.

The recovery in external demand is understood to be driving growth in tradable sectors, namely manufacturing (food beverages and tobacco, textiles, chemicals and the transportation equipment, machinery and tools subsectors), agriculture (estates subsector) and mining (non-oil and gas mining subsector). Similarly, stable domestic demand is providing the main driving force for growth in the non-tradable sectors of trade, transportation and communications and construction. Concerning the structure of the economy, the most important sectors are again manufacturing, the trade, hotels and restaurant sector and agriculture. However, the leading growth sectors are the transport and communications sector, agriculture and the financial services, leasing and corporate services sector.

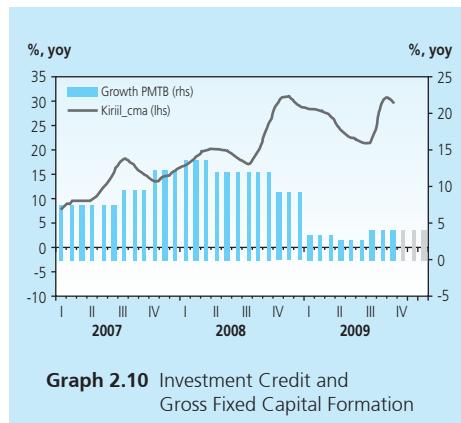
Inflation

CPI inflation in 2009 was down sharply from the preceding year, mainly in response to non-fundamentals.

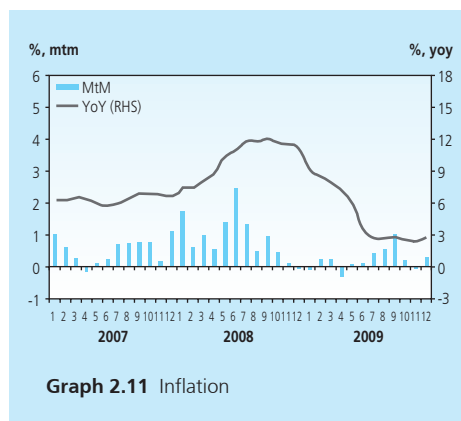
The drop in inflationary pressure is explained in part by falling international oil prices that prompted the government to reduce subsidised fuel prices in early 2009. The cut in subsidised fuel prices subsequently led to deflation in administered prices. Volatile foods inflation was also contained below normal levels in line with government support to safeguard supplies and the absence of food distribution bottlenecks. Complementing this was softening pressure from fundamentals. The drop in core inflation is related to softened pressure from external factors brought about by declining inflation in trading partner nations and the appreciation in the rupiah since end-Q1/2009. In response to these developments, CPI inflation reached 2.78% (yoy, Graph 2.11), well below the government-adopted inflation target of 4.5%±1%.

The ongoing recovery in the economy did not result in significant inflationary pressure during Q4/2009.

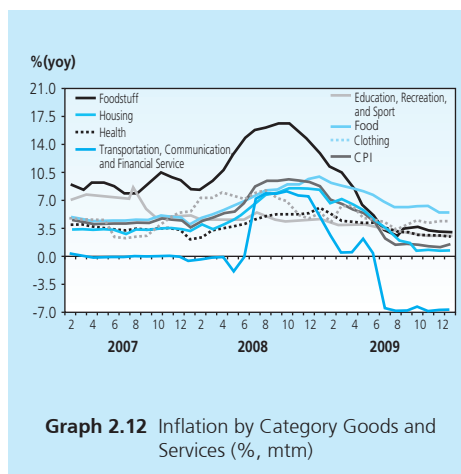
The impact of the seasonal factors of the religious festivities and New Year celebrations also came below historical trends. Measured quarterly, CPI inflation in Q4/2009 reached 0.49% (qtoq), down from the previous quarter's level of 2.07% (qtoq). The drop in inflation resulted primarily from the fall in volatile foods inflation in keeping with the seasonal trend in the aftermath of religious



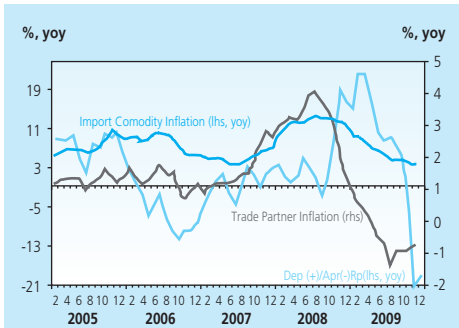
Graph 2.10 Investment Credit and Gross Fixed Capital Formation



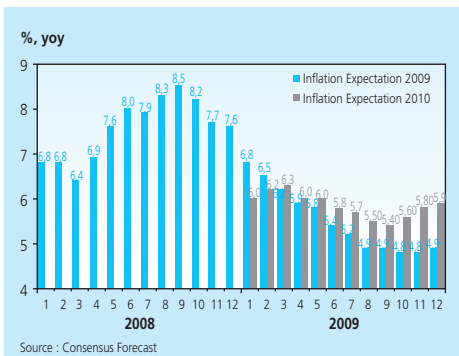
Graph 2.11 Inflation



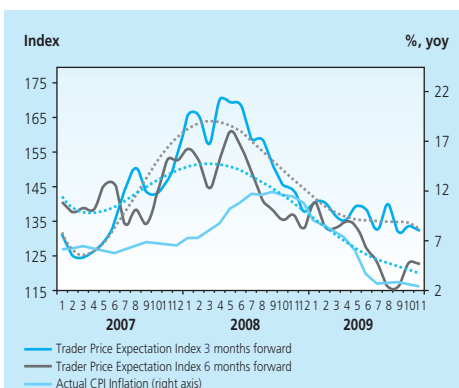
Graph 2.12 Inflation by Category Goods and Services (% mtm)



Graph 2.13 Import of Composite Wholesale Price Index Inflation, CPI of Import Commodity



Graph 2.14 Inflation Expectation - Consensus Forecast



Graph 2.15 SPE BI : Retailer Inflation Expectation

festivities. Concerning administered prices, inflation stayed very low due to the minimum impact of hikes in non-strategic administered prices. Similarly, inflationary pressure in fundamentals eased due to slackening pressure from imported inflation.

Analysed by influencing factors, the reduced inflation during Q4/2009 is explained primarily by non-fundamentals. Volatile foods inflation also maintained a downward trend due to price corrections in the wake of the Eid-ul-Fitr festivities and ongoing measures to ensure adequate distribution. The seasonal upswing associated with the Eid-ul-Adha, Christmas and New Year celebrations was below the normal trend, with market supply maintained at comfortably safe levels. In a similar vein, inflationary pressure from administered prices was kept to a minimum.

Analysed by expenditure category, the decline in inflationary pressure during the quarter resulted from lower pressure across almost all expenditure categories, with the steepest decline recorded in food stuffs (Graph 2.12). The drop in foodstuffs inflation is explained by price corrections following the Ramadan fasting month and the Eid-ul-Fitr festivities. Prices increases were recorded only the transportation category, a development that trimmed deflation to 3.67% following the steep 6.09% deflation in the preceding quarter. The lower deflation resulted mainly from substantial increases in air fares during Q4/2009, consistent with the seasonal pattern at end of year.

Measured quarterly, administered prices inflation came to 0.69%, up from the previous quarter's level of 0.61% (qtr). The rise in administered prices inflation resulted mainly from increases in cigarette prices believed to be linked to the 14% increase in cigarette excise and also in household fuel prices in response to shortages. However, the 15% hike in toll road charges on 28 September 2009 and 1.7% rise in bottled LPG on 10 October 2009 resulted in a minimal contribution to inflation at 0.01% for each item. Offsetting this were lower prices for non-subsidised fuels during the quarter under review, a result of falling international oil prices. Taken together, the annual measure of administered prices inflation came to 3.26% (yoy).

Inflationary pressure in volatile foods eased from the preceding quarter in response to secure supply conditions and the moderate level of global food stuff prices. Measured quarterly, volatile foods inflation reached 0.69%, having dropped sharply from the previous

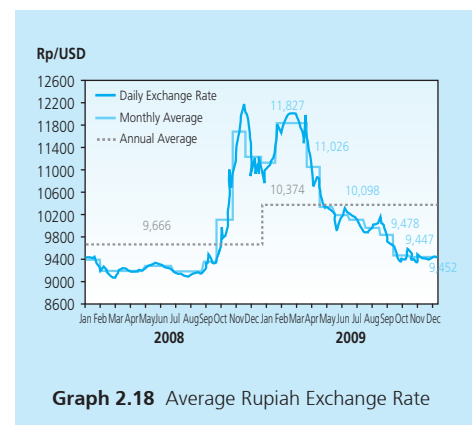
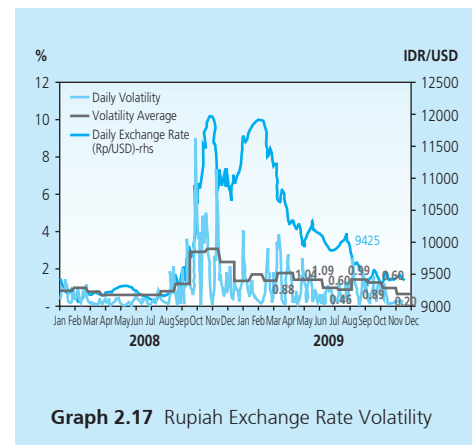
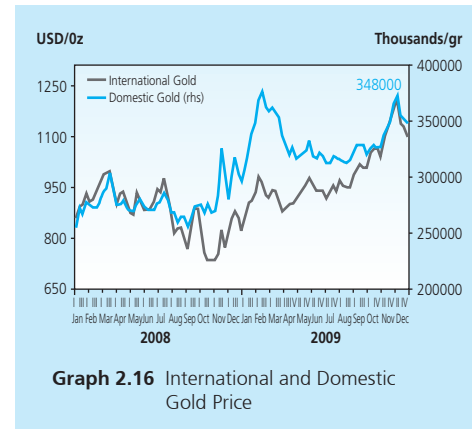
quarter's level of 5.38%. The fall in inflation is explained mainly by the seasonal pattern after the religious festivities. The quarter was marked by soaring prices for seasonings in the wake of harvest failures in some regions. In response to these developments, the annual rate of volatile foods inflation reached 3.95%, down from the previous quarter's level recorded at 4.98%.

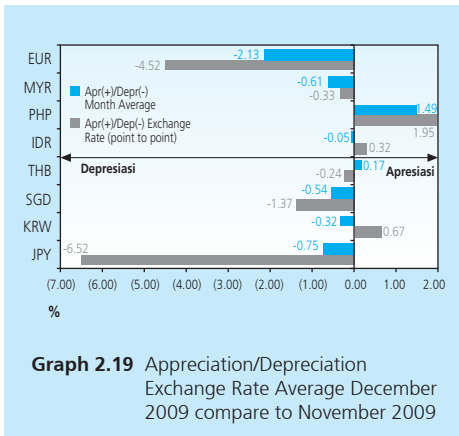
Consistent with the softening pressure from imported inflation, core inflationary pressure eased in comparison to one quarter earlier. The drop in inflation is explained primarily by reduced pressure from external factors brought about by the appreciation in the rupiah. However, while indications pointed to an upswing in demand, no significant upward pressure resulted on prices due to the adequate supply-side response. Accordingly, the quarterly measure of core inflation reached 0.79%, down from the 1.55% recorded in the previous quarter. In further developments, inflation expectations were generally stable in the absence of unfavourable shocks and relative decline in external pressures. Analysis of inflation by merchandise component shows that gold jewellery accounted for a significant share of Q4/2009 inflation at 0.13%. This is consistent with the steep rise in world gold prices throughout 2009. Accordingly, core inflation reached 4.28% (yoy), down than the previous quarter's level of 4.86% (yoy).

Rupiah Exchange Rate

Throughout 2009, the rupiah maintained an appreciating trend in response to the onset of recovery in the global economy and improved risk appetite among global investors. Movement in the rupiah also benefited from the equilibrium in domestic forex market demand and supply and the solid condition of Indonesia's economic fundamentals. Added support for the stability of the rupiah came from the robust fundamentals of the domestic economy. The resilience of the Indonesian economy in the face of external pressures was amply signalled to investors in the upbeat forecasts for the economy, high yields on rupiah instruments and a strong international reserves position at 66.1 billion US dollars, equivalent to 6.6 months of imports and servicing of official external debt.

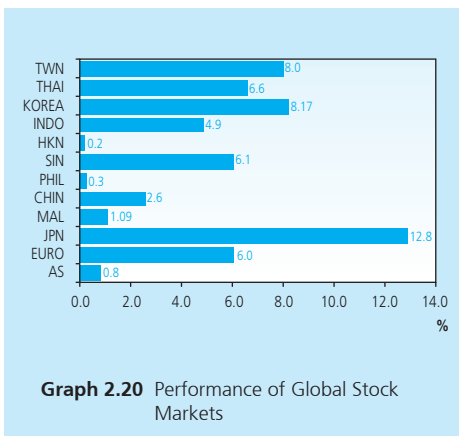
The exchange rate held generally stable during December 2009 as reflected in reduced volatility, despite modest depreciation. Volatility





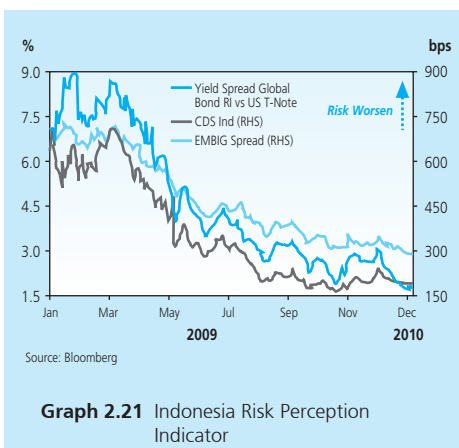
Graph 2.19 Appreciation/Depreciation Exchange Rate Average December 2009 compare to November 2009

in the rupiah fell from 0.60% in November to 0.20% in December. In monthly averages, the rupiah weakened 0.05% from Rp 9,447 to the USD in November to Rp 9,452 to the USD in December (Graph 2.17). At the end of the period, the rupiah closed at Rp 9,425 to the USD, having weakened 0.31% (ptp) from the November close of Rp 9,455 to the USD. Triggering this downturn in the rupiah was the Dubai World debt crisis, the downgraded credit rating for Greece and the deteriorating fiscal condition of some European nations. However, this condition proved short-lived in view of the steady progress in economic recovery in various regions, led by Asia. The average value of the rupiah during Q4/2009 came to Rp 9,459 to the USD. Similarly, for 2009 as a whole, the rupiah averaged Rp 10,374 to the USD.



Graph 2.20 Performance of Global Stock Markets

General perceptions of investment risk in Indonesia remained comparatively favourable. Despite jitters triggered by the Dubai World crisis in early December 2009, global investor perceptions of the Indonesian economy subsequently improved in line with the recovery on global financial markets. The EMBIG spread came down from 342 bps in November to 294 bps and the yield spread between RI Global Bonds and US T-Notes similarly eased from 295 bps in November to 174 bps. Likewise, CDS for Indonesia also narrowed to 192 bps from 229 bps in November 2009, in keeping with the decline in CDS across Asia (Graph 2.21). At this level, Indonesian CDS were better than for Vietnam, albeit still higher than for the Philippines. Investor perceptions of the rupiah exchange rate were again favourable, reflected in the stable movement of the swap premium indicator pointing to minimum potential pressure on the rupiah (Graph 2.22).



Graph 2.21 Indonesia Risk Perception Indicator

Yields on rupiah investments remained high in comparison to other countries in Asia. Uncovered Interest Rate Parity (UCIP) was largely stable compared to one month earlier in keeping with the Bank Indonesia decision to hold the BI rate at 6.5%. The UCIP indicator edged upwards only 7 bps to 6.51% from 6.44% in the preceding period. However, the Covered Interest Parity (CIP) indicator widened from 3.52% to 4.77% during the period under review, consistent with the improvement in risk indicators. The high yield spread on rupiah bonds compared to other Asian economies again proved attractive to foreign investors interested in rupiah instruments (Graph 2.23).

Monetary Policy

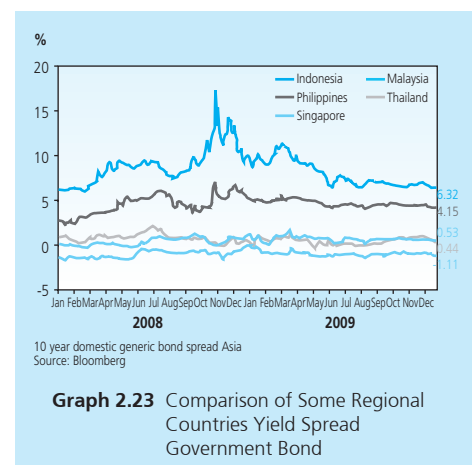
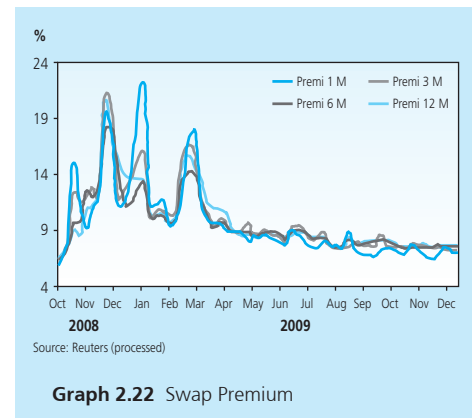
Interest Rates

During 2009, Bank Indonesia adopted a loose bias monetary policy stance commensurate with the decline in inflationary pressure. This policy was implemented through cumulative 275 bps reduction in the BI Rate as of August 2009, designed to stimulate general economic activity following the downturn brought on by the global crisis. In the outcome of these measures, current indicators suggest a renewed increase in inflationary pressure, which is set to return to normal levels in 2010. This calls for a monetary policy stance capable of anticipating this pressure but also seen as accommodating support for domestic economic recovery. Reflecting this stance was the steady level of the BI Rate at 6.5% since September 2009.

The reductions in the BI Rate transmitted smoothly to short-term interest rates. Reflecting this was the overnight interbank rate, which tracked movement in the BI Rate throughout 2009. The average daily overnight interbank rate came down 312 bps from 9.38% at end-2008 to 6.26% in December 2009. In addition, interbank rates remained stable at around the BI Rate level during 2009. This was consistent with the decision to switch the monetary policy operational target to the overnight interbank rate in July 2008, accompanied by strengthening of open market operation (OMO) instruments and standing facilities.

Transmission of short-term rates was matched by healthy transmission of the monetary policy stance to interbank rates in longer tenors. This points to improvement in perceptions of liquidity risk and reduced counterparty risk. Average interbank rates eased in above overnight tenors, with the effect most noticeable in tenors beyond 30 days. However, it is also important to note the microstructural condition of the interbank market in above 27-day tenors, which are more susceptible to asymmetric movement compared to more liquid tenors. This is explained by thin transaction volume and limited frequency of transactions.

Money market liquidity became more evenly distributed as a result of softening perceptions of money market risk. The daily average spread between high and low overnight rates narrowed, indicating less segmentation in the banking sector. Added to this were indications of



improving perceptions of liquidity risk in longer tenors, visible in the behaviour of banks engaging in longer range interbank transactions (60, 90 and 365 days) from October 2009. This also suggests a reduction in bank counterparty risk, particularly in regard to foreign banks and some regional development banks.

Transmission of monetary policy transmission to bank deposit rates also showed improvement.

From January to November 2009, banks responded to the cumulative 275 bps reduction in the BI Rate by lowering their 1-month deposit rates by 359 bps. This downward movement in deposits rates proceeded more satisfactorily compared to the previous period of BI Rate decline (2006-2007), when rates came down 226 bps over a similar period. After the BI Rate was placed on hold (September to December 2009), bank deposit rates continued to decline albeit in lesser magnitude. In other tenors above 6 months, deposit rates recorded very limited decline.

As regards lending rates, monetary policy transmission remained slow, particularly for consumption credit.

During 2009, the aggregated average lending rate (average of the interest rates for working capital credit, investment credit and consumption credit) eased by only 85 bps. This represents very limited movement in comparison to the changes in the BI Rate and 1-month deposit rates. In disaggregation by use, the most notable decline in lending rates during 2009 took place in investment and working capital credit, with rates falling 137 bps and 126 bps. However, consumption credit rates edged upwards by 7 bps, consistent with the less elastic nature of demand for this kind of credit to changes in interest rates. The rigidity in consumption credit rates is explained in

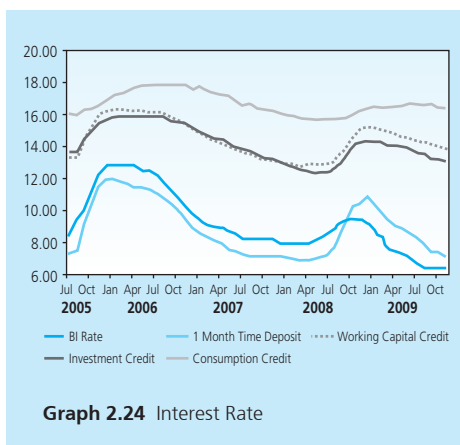


Table 2.1
Development of Various Interest Rates

Interest Rate (%)	2008		2009										
	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
BI Rate	9.5	9.25	8.75	8.25	7.75	7.5	7.25	7.00	6.75	6.5	6.5	6.5	6.5
Deposit Guarantee	10.00	10.00	9.50	9.00	8.25	7.75	7.75	7.50	7.25	7.00	7.00	7.00	7.00
1-month Deposit (Weighted Average)	10.40	10.75	10.52	9.88	9.42	9.04	8.77	8.52	8.31	7.94	7.43	7.38	7.16
1-month Deposit (Counter Rate)	14.07	14.16	14.18	13.98	13.94	13.78	13.64	13.40	13.20	13.00	12.96	13.01	12.94
Working Capital Credit	15.13	15.22	15.23	15.08	14.99	14.82	14.68	14.52	14.45	14.3	14.17	14.09	13.96
Investment Credit	14.28	14.4	14.37	14.23	14.05	14.05	13.94	13.78	13.58	13.48	13.2	13.2	13.03
Consumption Credit	16.24	16.4	16.46	16.53	16.46	16.48	16.57	16.63	16.66	16.62	16.67	16.53	16.47

party by the considerable share of credit for miscellaneous use, including unsecured credit and motor vehicle credit that command high rates of interest.

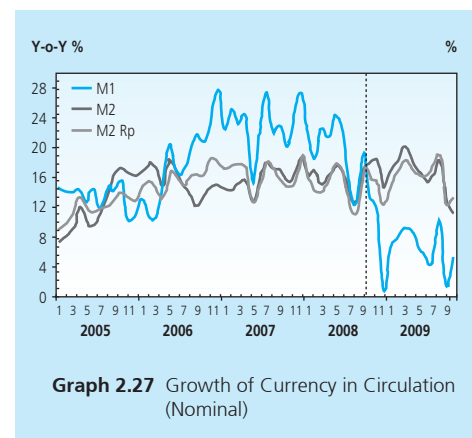
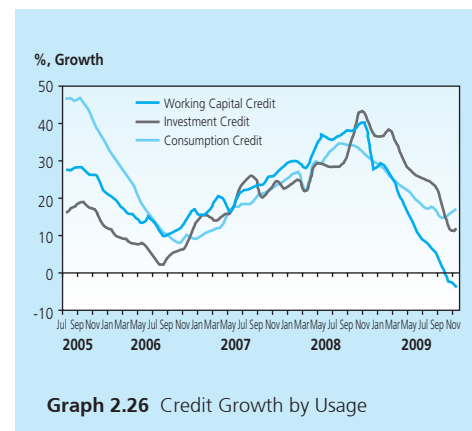
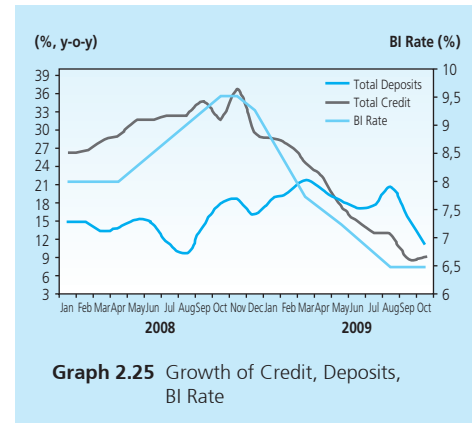
Funds, Credit and the Money Supply

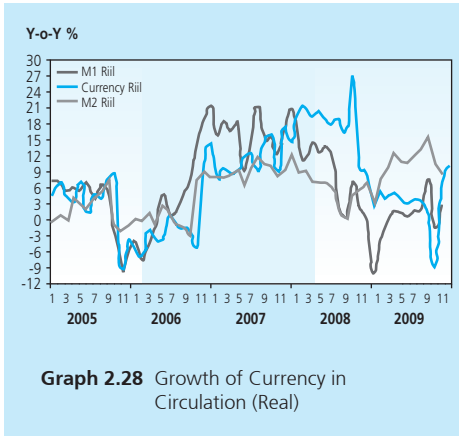
The year 2009 was marked by steady growth in depositor funds.

In November 2009, depositor funds had climbed Rp 143.7 trillion over the previous year-end position to Rp 1,897 trillion. The expanded funding position resulted from an added Rp 62.4 trillion in rupiah time deposits, comprising mostly personal deposits. Private business and personal savings deposits, representing another component of depositor funds, have also maintained an upward trend since Q3/2009 due to the lowering of time deposit rates. In other developments, foreign currency deposits fell by Rp 9.1 trillion, due to the strengthening of the rupiah. Despite the overall increase in depositor funds, funding growth remained sluggish as of November 2009 at only 11.1% (yoy), down from the previous year-end growth that reached 16.1% (yoy) (Graph 2.25).

In the credit channel, monetary policy transmission was again hampered by the slow pace of domestic economic growth and high loan interest rates. From January to November 2009, credit expansion (including channelling) reached only Rp 77.3 trillion, bringing total outstanding credit to Rp 1,430.9 trillion with growth at only 5.7% (ytd). This represented a much lower rate of growth compared to the Rp 297.8 trillion or 28.5% (ytd) credit expansion (including channelling) for the same period in 2008. As a result, annual credit expansion as of November 2009 slowed to 4.3% (yoy) from the end-2008 level of 29.5% (yoy) (Graph 2.25).

Analysed by category of use, consumption credit again recorded brisk growth, contrasting to the steep correction in working capital credit (Graph 2.26). In November 2009, annual growth in consumption credit stood at 17.3% (yoy), having slowed from the previous year's level of 29.9%. Working capital credit contracted by 3.1% (yoy) with lending down for manufacturing and business services, as expected with the slow pace of domestic economic recovery in the two sectors. This was one factor in the persistently sluggish rate of overall credit expansion. In disaggregation by sector, lending to the electricity, water and gas utilities sector maintained relatively brisk growth, a result of the ongoing construction of power infrastructure. As of November 2009, credit





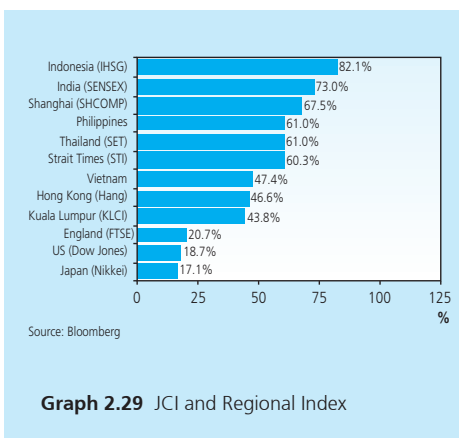
Graph 2.28 Growth of Currency in Circulation (Real)

expansion in the electricity, water and gas utilities sector reach 27.1% (yoy) and 27.3% (ytd), the most aggressive for any sector. Despite this, overall credit expansion slowed further in all economic sectors.

The slowing economic growth trend was reflected in similarly slack growth in M1. In November 2009, M1 was up by Rp 41.2 trillion, while M2 and Rupiah M2 expansion over end-2008 reached Rp 168.9 trillion and Rp 142.9 trillion. As a result, annual growth in M1 economic liquidity slipped to 6.7% in 2009 from the 2008 level of 17.1%. In contrast, the annual rate of expansion in M2 was stable at about 16% (Graphs 2.27 and 2.28). The slack M1 growth compared to the preceding year is explained by changing behaviour in demand deposits. In contrast, the accelerated growth in M2 and Rupiah M2 was fuelled mainly by the expansive nature of government financial operations. The conditions described above suggest that the economic activity in society is expanding at only a modest pace.

The Stock Market

The loose bias monetary policy during 2009 has boosted asset prices with gains reflected in the JSX Composite Index (JCI). The 275 bps decline in the BI Rate during 2009 was transmitted into gains in the JCI, which soared 87% (yoy). This represents the steepest rate of index growth in the region (Graph 2.29). At end-2009, the JCI closed at 2,534.36. The steep ascent of the JCI was spurred not only by the changes in the BI Rate, but also external factors such as stock market performance in the region (the STI). The gathering momentum of the ongoing global economic recovery imbued investors with renewed confidence in asset placements. An added factor was the improving situation of global liquidity, which in turn boosted global financial market performance and created positive sentiment for emerging financial markets, including Indonesia. At home, the conducive domestic macro and microeconomic indicators also contributed to the JCI gains. On the macro side, upbeat signals were observed in such indicators as the appreciation of the exchange rate, positive level of economic growth, subdued inflation and political stability. At the micro corporate level, stock-listed companies were able to book an increased level of aggregate operating profit and net earnings during 2009. This has prompted some issuing companies to plan for increased capital expenditures in 2010. In keeping with these dynamics, the domestic stock market and regional markets underwent some easing of risk factors.



Graph 2.29 JCI and Regional Index

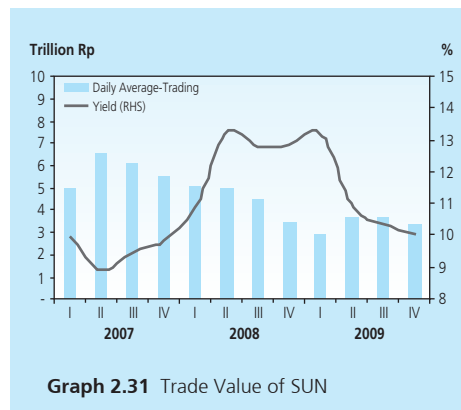
Trading volume on the domestic stock market remained stable during 2009. Share trading volume reached Rp 3.99 trillion per day, comparatively stable in comparison to the Rp 4.41 trillion daily volume in the preceding year (Graph 2.30). During 2009, the net foreign purchase totalled Rp 13.92 trillion, down from the preceding year's level of Rp 18.65 trillion. Even so, renewed inflows of foreign capital in the second and third quarters eventually bolstered domestic investor confidence. In sectoral analysis, commodity-based sectors such as mining and estates achieved the most significant gains in line with the rebound of commodity prices on the international market. Surprisingly, the surge in the mining and multifarious industry index surpassed the average for other sectors.



Graph 2.30 Jakarta Composite Index (JSX) and Trade Value

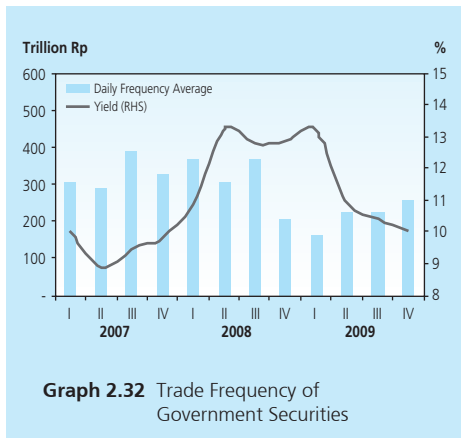
The Government Securities Market

On the government securities market, monetary policy transmission was reflected in lower yields with varying magnitude of decline by tenor. The cumulative 275 bps cut in the BI Rate during 2009 was followed by an average 246 bps fall in yield. Shorter tenor government securities responded more vigorously with lower yield. Yield on government securities in short, medium and long tenors came down by 375 bps, 239 bps and 130 bps. Influencing the yield dynamics on the government securities market were various external and domestic factors. Externally, the recovery in government securities was driven by keen foreign investor interest on the government securities market. The slashing of the Fed Funds rate to 0%-0.25% and abundance of global liquidity prompted investors to begin shifting their investments to high-yielding assets, including Indonesian government securities. Alongside this, Indonesia's risk indicated by the CDS also improved, providing a further boost to investor confidence in Indonesian government securities. Complementing this on the domestic front, macroeconomic indicators remain at comfortably safe levels. Appreciation in the exchange rate, positive economic growth and subdued inflation provided positive signals for investors. The conducive effect of fiscal sustainability¹ on the government securities market is explained by the modest pressures on government finances.

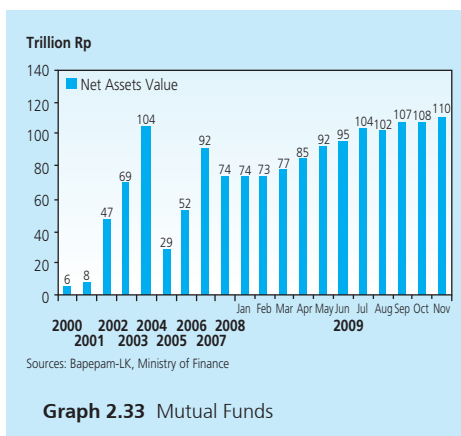


Graph 2.31 Trade Value of SUN

1 One of the indicators used is the debt stock to GDP ratio.



Graph 2.32 Trade Frequency of Government Securities



Graph 2.33 Mutual Funds

In similar developments, renewed foreign investor confidence boosted liquidity on the government securities market. Foreign investors increased their holdings of government securities by Rp 20.1 trillion, ahead of the Rp 9.6 trillion recorded in the preceding period. However, the expanded ownership of government securities was not matched in trading volume, which in fact recorded average decline. During 2009, daily trading volume in government securities came to Rp 3.39 trillion, down from the 2008 level of Rp 4.49 trillion (Graph 2.31). Despite lower trading volume, average frequency of government securities trading mounted from 266.3 transactions per day to 270.8 per day (Graph 2.32).

Mutual Funds Market

The sustained monetary policy relaxation during 2009 and lowering of bank deposit rates coupled with more robust performance in underlying assets helped to boost NAV recorded by mutual funds. Net Asset Value (NAV) at 16 December 2009 stood at Rp 113 trillion, a considerable increase over the corresponding NAV in early 2009 recorded at only Rp 74.3 trillion (Graph 2.33). The most important contributions to the increased NAV came from equity, protected and fixed income funds. In November 2009, NAV in these three categories reached Rp 36.5 trillion, Rp 33.7 trillion and Rp 13.2 trillion.

Fund managers have responded to the conducive levels of macroeconomic stability by issuing new mutual fund products, which in turn has stimulated trading activity in mutual funds. New products include sharia-compliant mutual funds and collective investment contract funds. Other policies that helped boost mutual funds NAV include the final withholding tax rate set at 0%, effective for interest and discount on bonds earned in 2009-2010.

Condition of the Banking System

The overall performance of the banking sector was generally sound throughout 2009. Key banking indicators, such as the Capital Adequacy Ratio (CAR), Non-Performing Loans (NPLs), Net Interest Margin (NIM) and Return on Assets (ROA) held at comfortable safe and stable levels amid unstable global conditions. NPLs were kept below 5% while the CAR remained at a solid 17%, well above the BI-prescribed 8% minimum. In similar developments, Return on Assets (ROA) and Net Interest Margin (NIM) were stable at 2.6% and 0.5% (Table 2.2).

Tabel 2.2
Main Indicators of Banking System

Main Indicators		2008		2009										
		Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Total Asset	(T Rp)	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	2,392.7	2,439.7
DPK	(T Rp)	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	1,863.5	1,897.0
Credit	(T Rp)	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	1,410.4	1,430.9
LDR	(%)	80.3	77.2	75.9	75.5	75.1	74.8	75.1	75.0	75.8	75.8	75.4	75.7	75.4
NPLs Gross*	(%)	4.0	3.8	4.2	4.3	4.5	4.6	4.7	4.5	4.6	4.5	4.3	4.3	4.4
NPLs Net *	(%)	1.5	1.5	1.6	1.6	1.9	2.0	1.9	1.7	1.7	1.5	1.3	1.2	1.4
CAR	(%)	16.3	16.2	17.6	17.7	17.4	17.6	17.3	17.0	17.0	17.0	17.7	17.6	17.0
NIM	(%)	0.5	0.5	0.5	0.3	0.6	0.5	0.5	0.5	0.5	0.5	0.4	0.5	0.5
ROA	(%)	2.6	2.3	2.7	2.6	2.8	2.7	2.7	2.7	2.7	2.7	2.6	2.7	2.6

* with channeling

III. MONETARY POLICY RESPONSE

On 6 January 2010, the Board of Governors of Bank Indonesia decided to hold the BI Rate at 6.5%. In the view of the Board of Governors Meeting, the present 6.5% level of the BI Rate remains consistent with achievement of the 5%±1% inflation target for 2010 and offers adequately conducive conditions for the economic recovery and banking intermediation processes.

Latest Indicators

FINANCIAL SECTOR	2008	2009											
	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
INTEREST RATE & STOCK													
One month SBI 1)	10.83	9.50	8.74	8.21	7.59	7.25	6.95	6.71	6.58	6.48	6.49	6.47	-
Three month SBI 1)	11.08	9.93	9.25	8.61	7.95	7.39	7.05	6.79	6.63	6.55	6.60	6.59	-
One month Deposit 2)	10.75	10.52	9.89	9.42	9.04	8.77	8.52	8.31	7.94	7.43	7.38	-	-
Three month Deposit 2)	11.16	11.34	11.13	10.65	10.09	9.68	9.25	8.99	8.73	8.35	7.97	-	-
One week JIBOR 2)	10.01	9.43	8.71	8.30	8.03	7.69	7.09	6.96	6.56	6.46	6.46	6.47	-
JSX Indices 3)	1,355	1,333	1,285	1,434	1,723	1,917	2,027	2,323	2,342	2,468	2,368	2,416	2,534
MONETARY AGGREGATES (billions Rp)													
Base Money	344,688	314,662	303,777	304,718	308,277	309,232	322,994	322,850	324,663	354,297	364,869	376,938	-
M1(C+D)	466,379	437,388	434,233	448,452	454,221	455,364	483,053	469,346	490,575	490,501	485,979	-	-
Currency (C)	209,378	191,339	186,611	186,538	191,194	192,143	203,838	201,172	200,871	210,822	206,305	213,362	-
Demand Deposit (D)	257,001	246,049	247,622	261,914	263,027	263,221	279,215	268,174	289,704	279,679	279,674	-	-
Broad Money (M2 = C+D+T)	1,883,851	1,754,293	1,773,980	1,794,004	1,794,888	1,807,388	1,859,690	1,841,112	1,871,955	1,889,157	1,900,257	-	-
Quasi Money (T)	1,417,472	1,316,905	1,339,747	1,345,553	1,340,667	1,352,024	1,376,637	1,371,766	1,381,381	1,398,656	1,414,278	-	-
Quasi Money (Rupiah)	1,136,979	1,175,565	1,190,990	1,202,724	1,205,976	1,217,906	1,245,822	1,245,247	1,251,225	1,272,217	1,284,847	-	-
Time Deposit	662,629	686,919	703,027	706,002	705,379	715,139	726,088	724,888	727,889	731,202	740,705	-	-
Saving Deposit	474,350	488,645	487,964	496,722	500,597	502,767	519,733	520,359	523,336	541,015	544,142	-	-
Foreign Currency Deposit	280,493	141,341	148,757	142,828	134,691	134,118	130,815	126,519	130,156	126,439	129,431	-	-
Broad Money Rupiah	1,603,358	1,612,953	1,625,223	1,651,176	1,660,197	1,673,270	1,728,875	1,714,594	1,741,800	1,762,718	1,770,826	-	-
Claim on Business Sector	1,314,049	1,293,600	1,305,681	1,303,885	1,292,306	1,298,095	1,320,131	1,333,469	1,351,511	1,348,857	1,360,724	-	-
Credit by DMBs	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)	-0.04	-0.07	0.21	0.22	-0.31	0.04	0.11	0.45	0.56	1.05	0.19	-0.03	0.33
CPI - 1 year (% , yoy)	11.06	9.17	8.60	7.92	7.31	6.04	3.65	2.71	2.75	2.83	2.57	2.41	2.78
EXTERNAL SECTOR													
Rp/USD (endperiod,midrate)	10,950	11,355	11,980	11,575	10,713	10,340	10,225	9,920	10,060	9,681	9,545	9,480	9,445
Non oil/gas Export (f.o.b, million USD) ⁴⁾	7,394	6,345	6,713	7,473	7,053	8,229	8,470	8,437	8,966	8,735	9,714	-	-
Non oil/gas Import (c\$, million USD) ⁴⁾	7,396	5,706	5,008	5,819	5,488	6,366	6,987	7,720	7,313	6,507	7,405	-	-
Net International Reserve (million USD)	48.39	47.96	47.17	50.68	51.72	51.65	50.99	50.72	50.84	53.81	55.68	56.15	57.61
QUARTERLY INDICATOR		2009											
		Q.I	Q.II	Q.III									
Real GDP Growth (% y-o-y)		4.40	4.00	4.20									
Consumption		7.30	6.30	5.40									
Investment		-0.80	3.20	4.20									
Changes in Stocks		-146.40	88.20	23.80									
Export		-18.70	-15.50	-8.20									
Import		-26.00	-23.90	-18.30									

* 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)