

SUR/08/87

August 5, 20008

**The Acting Chair's Summing Up  
Indonesia—2008 Article IV Consultation  
Executive Board Meeting 08/72  
August 1, 2008**

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the resilience of the Indonesian economy to the global slowdown and financial market turmoil, underpinned by strong macroeconomic fundamentals and the highly liquid and well-capitalized banking system. Robust domestic demand and buoyant exports supported by high commodity prices have contributed to this commendable performance, and are expected to continue to sustain the growth momentum. Downside risks are associated with a less favorable external environment, a possible slump in commodity prices, and remaining vulnerability to spikes in global risk aversion and contagion from other emerging markets.

Directors saw as a key immediate challenge the need to rein in the inflationary pressures stemming from the large increases in food and fuel prices and strong domestic demand. They welcomed the recent increases in interest rates, and considered that further monetary policy tightening will be needed to put inflation back on a firmly declining path. Directors encouraged the authorities to continue to strengthen the inflation targeting framework, through effective communication, publication of inflation forecasts, and a strong commitment to the medium-term targets. They agreed that the shift of the operational target to the interbank overnight rate has been managed well and will enhance the effectiveness of monetary policy.

Directors considered Indonesia's flexible exchange rate policy appropriate. Noting the staff's assessment that the real effective exchange rate may be somewhat undervalued, Directors welcomed the new policy of increased reselling of oil receipts, which should help strengthen the currency and support monetary policy in dampening inflationary pressures. They underscored that such a policy should be pursued with care to avoid creating perceptions of specific exchange rate targets. At the same time, efforts should continue on the structural front to strengthen external competitiveness. While reserve levels are broadly adequate, some additional accumulation over the medium term could further reduce vulnerabilities.

Directors welcomed Indonesia's strong fiscal performance. They considered the fiscal stance appropriate and consistent with a substantial reduction of the public debt burden.

Directors commended the authorities for addressing the challenge of energy subsidies through the recent fuel price increase, accompanied by cash transfers to the poor. Going forward, Directors encouraged the authorities to move toward an automatic fuel price adjustment mechanism, which would be the preferred solution to ensure fiscal space for capital and social expenditures and guard against emerging concerns about the sustainability of subsidies. In the interim, further ad-hoc adjustments would help reduce the cost of fuel subsidies. Directors welcomed the progress made in public finance reforms, and looked forward to the completion of the pending reforms of the tax system and tax administration. To further enhance fiscal transparency, the authorities were encouraged to consider participating in the Extractive Industries Transparency Initiative.

Directors observed that Indonesia's banking system remains relatively resilient to macroeconomic shocks and exchange rate risks. They agreed that the rapid credit growth calls for close monitoring and strict adherence to prudential regulations in line with international standards. Directors supported the planned gradual transition to Basel II, and welcomed the review of the financial safety net, with a view to ensuring timely responses in case of a crisis. They looked forward to Indonesia's early participation in the FSAP.

Directors welcomed progress toward implementing structural reforms over the past year. Further efforts will nevertheless be needed to achieve higher sustainable GDP growth, aimed particularly at improving the business climate and accelerating infrastructure development. In that regard, Directors viewed the recently announced policy packages as a welcome signal of the authorities' intention to press ahead with the structural reform agenda.

It is expected that the next Article IV consultation with Indonesia will be held on the standard 12-month cycle.