SM/08/238
Correction 1

September 3, 2008

To: Members of the Executive Board

From: The Secretary

Subject: **Indonesia—Selected Issues**

The attached correction to SM/08/238 (7/11/08) has been provided by the staff:

Factual Error Not Affecting the Presentation of Staff's Analysis or Views

Page 31, paragraph 46, line 3: for "Current reserve levels are somewhat below the level predicted by a simple model of optimal reserves, suggesting that some accumulation over the medium-term could help continue reducing vulnerabilities" read "While the estimates are sensitive to parameters and assumptions, the study suggests that current reserve levels are likely somewhat below the level predicted by simple model of optimal reserve, suggesting that some accumulation over the medium-term could help continue reducing vulnerabilities."

Questions may be referred to Mr. Reichold (ext. 39974) and Ms. Ruiz-Arranz (ext. 38564) in APD.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (1)

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Department Heads

Table 5. Thresholds in the spreads-reserves relation

	Threshold 1		Threshold 2		Reserve Adequacy Benchmark
Reserves to	Estimate	Confidence interval	Estimate	Confidence interval	
GDP 1/	49	[23, 51]	...	...	...
Months of imports 2/	6	[2, 9]	...	...	3
Broad money 2/	28	[6, 85]	...	...	5–20
Short-term debt 2/	125	[112, 692]	534	[534, 535]	100
Foreign liabilities 3/	12	[12, 12.4]	52	[52, 66]	...
Fin. system deposits and equities 3/	13	[12, 14]	30	[14, 40]	...

1/ The marginal impact of reserves is negative and significant below threshold 1; there are insufficient observations to estimate the impact above the threshold.
2/ The marginal impact is negative below threshold 1 and not significant above the threshold.
3/ The marginal impact is not significant below threshold 1, negative between threshold 1 and 2, and insignificant above threshold 2.

E. Conclusions

46. **In assessing reserve adequacy in Indonesia, the empirical analysis concludes that current reserve levels are comfortable, but there is scope for some further accumulation over the medium-term. While the estimates are sensitive to parameters and assumptions, the study suggests that c**~~C~~urrent reserve levels are likely somewhat below the level predicted by a simple model of optimal reserves, suggesting that some accumulation over the medium-term could help continue reducing vulnerabilities. Furthermore, reserve accumulation continues to have a positive impact in reducing borrowing cost for both the government and the private sector.

47. **Finally, continued reserved accumulation would make the economy more resilient from a financial stability point of view.** However, the accumulation should be at a slower pace than in 2007, which would also help alleviate inflationary pressures. As discussed in the staff report, the current policy of recycling some of the proceeds from oil exports while safeguarding international reserves is appropriate.

Table 6. Threshold estimates of the elasticity of EMBI spreads with respect to international reserves
Traditional indicators

	GDP	Months of Imports		Broad Money		Short term debt		
Thresholds	< 49	< 6.3	> 6.3	< 28.3	> 28.3	< 125	[125, 534]	> 534
Spreads-reserves elasticity	-0.425***	-0.329***	-0.004	-0.463***	0.167	-0.31	-0.311*	-0.531
	(0.11)	(0.12)	(0.37)	(0.17)	(0.25)	(0.20)	(0.19)	(0.37)
Observations	286	176	112	151	144	80	169	38
R-squared	0.53	0.5	0.46	0.42	0.46	0.24	0.6	0.7

Note: Robust standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%.

Table 7. Threshold estimates of the elasticity of EMBI spreads with respect to international reserves.
New indicators

	Total foreign liabilities			Financial system deposities and equities		
Thresholds	< 12	[12, 52]	> 52	< 13	[13, 30]	> 30
Spreads-reserves elasticity	-0.13	-0.419**	-0.253	0.035	-0.609*	0.259
	(0.15)	(0.19)	(0.71)	(0.18)	(0.32)	(0.24)
Observations	82	182	12	47	132	74
R-squared	0.33	0.6	0.77	0.46	0.49	0.6

Note: Robust standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%.