International Monetary Fund

Statement at the Conclusion of the 2013 Article IV Consultation Mission to Indonesia

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An International Monetary Fund (IMF) team, led by David Cowen, Advisor for the Asia and Pacific Department, visited Jakarta during August 19–30, 2013 to conduct the 2013 Article IV Consultation discussions. The team exchanged views with the government and Bank Indonesia (BI) on the impact of recent global developments and spillovers on Indonesia's economy and the near-term outlook. It also met with a wide range of private sector representatives. Based on the visit, a staff report will be prepared and presented to the IMF's Executive Board in early November.

At the conclusion of the visit, Mr. Cowen issued the following statement:

"Over the past year, the global economic environment has become more challenging for Indonesia. A further fall in commodity prices and slowing growth in major emerging markets (EMs) trading partners has adversely affected Indonesia's export performance. An increase in net oil and gas trade imbalance has added to pressures. More recently, the prospect of a gradual exit from unconventional monetary policies in some advanced economies has prompted a marked shift in financing conditions for EMs, with the effects on Indonesia intensified by its external imbalances.

"Under these conditions, the current account deficit is expected to widen to around 3½ percent of GDP in 2013. GDP growth is projected to slow to around 5¼ percent in 2013 on sluggish external demand and the investment outlook, but is expected to be supported in 2014 by improved global prospects and election-year spending. Headline inflation is projected to rise to 9½ percent (year-on-year) by end 2013, factoring in June 2013 fuel price adjustments, before easing back to 6 percent in 2014. Risks to this outlook center on a deeper-than-expected slowdown in EMs and/or more adverse investor sentiment toward them, which could add external pressures and exacerbate imbalances in Indonesia.

"To address macroeconomic pressures and reduce current vulnerabilities, BI has taken credible steps to tighten monetary policy, most recently through an increase on August 29 in its policy rate to 7 percent. Major fuel price adjustments in June 2013 have helped contain the fiscal deficit. Monetary policy should continue to focus on anchoring inflation expectations, reining in the current account deficit, and maintaining a healthy reserve buffer. Fiscal policy will need to support monetary policy in this effort, underpinned by further tax and subsidy reforms to ensure adequate space for social and capital spending, including new health protections in 2014. Early steps to further reinforce monetary and fiscal buffers, supported by continued flexibility in the exchange rate and bond yields, would help the economy absorb shocks.

"In view of the current environment, moves to strengthen macroprudential surveillance and ensure a smooth transition of banking supervision from BI to the Financial Services Agency (OJK) should help maintain a stable financial system. Concentrated efforts to deepen financial markets should also make the banking system more resilient to liquidity pressures and help mobilize longer-term savings needed to support investment. A strengthening of the current supervisory architecture pending the passage of the Financial Safety Net Law is a priority to managing risks.

"More intense structural reform efforts are needed to reduce supply bottlenecks, broaden the export base, and bolster medium-term economic and employment growth, in order to provide more opportunities for Indonesia's youthful labor force and facilitate greater regional and global integration. The main priorities continue to be accelerating infrastructure investment, creating a more open and predictable trade and investment regime, and reducing labor market rigidities."

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