

Country Brief : Indonesia

Macroeconomic policy management over the past year and efforts to fight terrorism have helped to lift sentiment. However, political uncertainty in the lead-up to parliamentary and presidential elections in 2004, security risks and pace of reform post-IMF are likely to leave investors cautious and limit long-term capital inflows.

Upcoming elections will dominate the political scene

Legislative elections are due on 5 April 2004 and the first round of the country's first-ever direct presidential elections is scheduled for 5 July 2004 with a run-off on 20 September. The military, which currently holds 38 non-elected seats in the House of Representatives (DPR), will lose this allocation, ending its formal political representation in parliament. The PDI-P currently holds the largest representation in the DPR, followed by Golkar. Some 50 political parties have registered to participate in the forthcoming elections but the General Elections Commission will announce the list of eligible parties in early December.

Only political parties can field presidential candidates. President Megawati of the PDI-P has a tough fight ahead in her bid to retain the presidency. There are seven candidates, including Golkar chairman Akhbar Tandjung and former military chief General (ret.) Wiranto, vying for the Golkar nomination. The final decision is likely to be made after the legislative elections. Noted Muslim scholar Nucholish Madjid, who had withdrawn his nomination to run on a Golkar ticket following Akhbar Tandjung's decision to participate, has kept his presidential ambitions alive, asserting that he has the support of three political parties. Other possible contenders include Bambang Susilo Yudhoyono (security minister), Hamzah Haz of the United Development Party (current vice president) and Amien Rais of the National Mandate Party (chairman of the People's Consultative Assembly-MPR) who appears to be soliciting support from Islamic parties to prevent President Megawati from being re-elected.

While presidential candidates are gradually making their intentions known, political/economic manifestos remain unclear. The lead up to the presidential elections is likely to be fraught with political jostling for support and strategic alliance-building, adding to uncertainty as the country treads new ground in terms of a direct vote for the presidency. However, our main case scenario assumes that the outcome will not produce a dramatic macroeconomic policy shift in a bid not to undo the efforts of the past two years to lift Indonesia's political and economic profile. This is particularly pertinent as investors wait in the

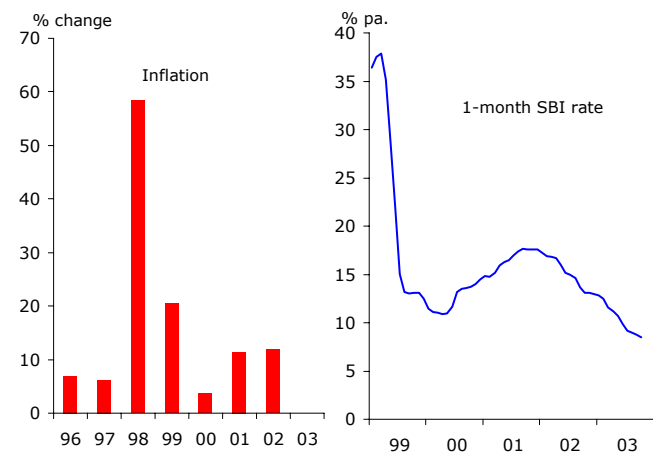
sidelines as the IMF exits from the scene at the end of the year.

Indonesia decided not to renew its funding arrangement with the IMF upon expiry in December 2003. However, it has agreed to post-programme monitoring, with the IMF providing advice without imposing reform. The current administration released a White Paper on a new reform agenda in September, which was well received. However, the favourable response was tinged with some caution as the time frame for the implementation of some reforms appeared ambitious given that elections were less than a year away.

Steady economic growth but not enough to make a serious dent in unemployment

The economy has been growing at a 3½-4% pace in year-on-year terms, over the past four quarters, with private consumption being the main driver of growth. Real GDP expanded by 3.6% in the first half of 2003 compared with the same period in 2002. An improvement in consumer and business sentiment and a pick-up in external demand should help to lift economic growth further in the second half of this year and into next year. Real GDP is forecast to expand by around 4-4½% for 2003 and 2004.

Inflation and interest rates ease

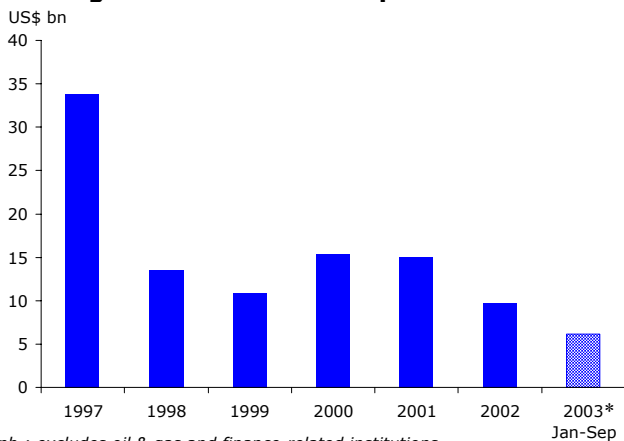


Rupiah appreciation and relatively stable food prices have helped to reduce inflation, which stood at 6.2% over the year to September, the lowest rate since August 2000. For the first nine months of

2003, inflation averaged 7% compared with 11.9% for the full year 2002. This has helped to provide a more conducive interest rate environment. Interest rates have eased over the course of the year, with the one-month SBI rate at around 8.5% at the end of October compared with 12.9% at end-2002.

The budget deficit has been successfully reduced, helped by the partial lifting of subsidies, a decline in domestic interest rates and higher revenues. Fiscal consolidation remains the main focus, particularly so for 2004 as the IMF ceases to provide financial support. The draft budget for 2004 projects a deficit of 1.2% of GDP from 1.9% for 2003 which is likely to be largely financed through domestic sources. Revenues are expected to rise by 2.3% from that budgeted for 2003 and total expenditure is forecast to fall by around 0.5%. Subsidies and debt service payments collectively account for close to half of central government current expenditure in the draft budget for 2004 - an improvement over 2003 but still a severe constraint on expenditure plans.

Foreign investment below pre-crisis levels



nb : excludes oil & gas and finance-related institutions
Source : Investment Coordinating Board (BKPM)

Foreign direct investments have been weak. For the first nine months of 2003, foreign direct investment approvals rose to US\$6.16 bn compared with US\$5.94 bn for the same period in 2002 but this pales in comparison with an average of over US\$30 bn per year between 1994 and 1997. The incipient recovery is likely to have been undermined by the Marriott hotel bombing in August. In addition, uncertainty ahead of the elections as well as prevailing concerns over corporate governance and legal reform are likely to cloud the investment climate.

Steady economic growth, falling inflation and lower interest rates bode well for the economy. However, budget constraints together with the lack of a strong pipeline of investment will make it difficult to put the economy on a sustainable growth path exceeding 6% per annum - a rate needed to make serious inroads into reducing unemployment. Some 40 mn

people are estimated to be unemployed representing about 40% of the workforce.

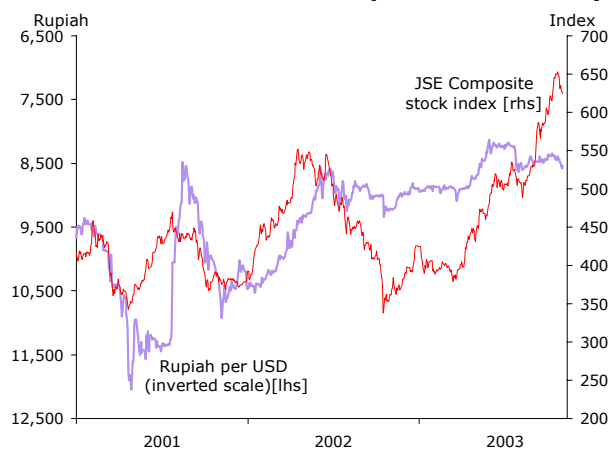
Current account surplus likely to narrow

The trade surplus for the first eight months of this year was US\$18.3 bn, up slightly from the same period in 2002. However, exports, which performed strongly at the start of the year, growing by around 16% in Q1 2003 over the same period in 2002, have grown at a much slower pace in recent months. Exports in August were just 0.9% higher than the same month last year. Imports have declined in recent months in year-on-year terms largely reflecting sluggish capital and intermediate goods imports. The outlook is for stronger export earnings as external demand gains momentum but this will be accompanied by higher imports, which is likely to produce a smaller, but still healthy, trade surplus. A smaller trade surplus together with an anticipated increase in the services deficit is likely to result in a narrower current account surplus in 2004 of around 2½% of GDP from an estimated 3% of GDP in 2003.

Financial markets resilient

Indonesia's financial markets weathered the shock of the Marriott hotel bombing in August, underscoring confidence in the domestic economy. Macroeconomic policy management over the past year and efforts to fight terrorism have helped to lift sentiment. After an initial dip, the stockmarket picked up, rising by close to 30% since the bombing on 5 August. Since the start of the year, the stockmarket has risen by around 47%. The rupiah has edged up slightly. It was trading at around Rp8,500/USD on 31 October from Rp8,605/USD on 5 August but has appreciated by some 5% since end-December 2002.

Stockmarket soars and rupiah holds steady

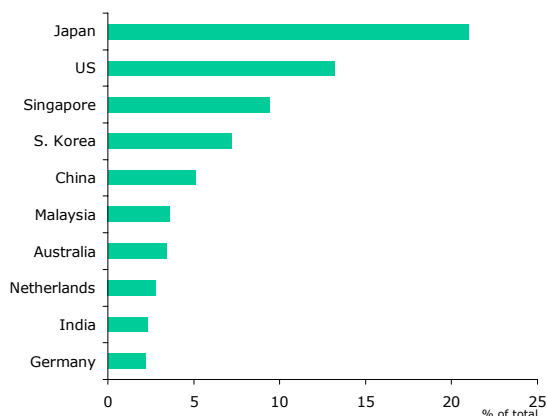


Source : Datastream

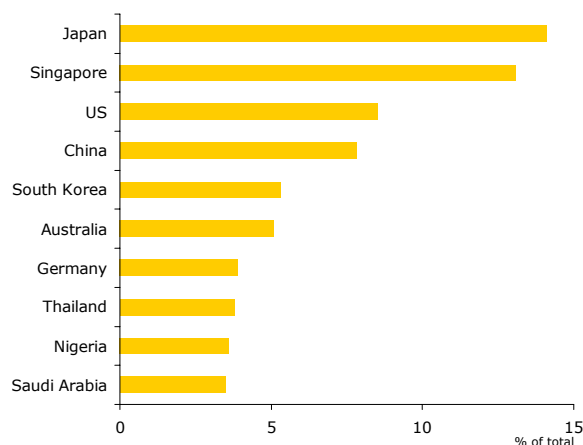
Jasmine Robinson
Economics@ANZ Email: robinsj7@anz.com

Indonesia's foreign trade

Indonesia's main export markets 2002



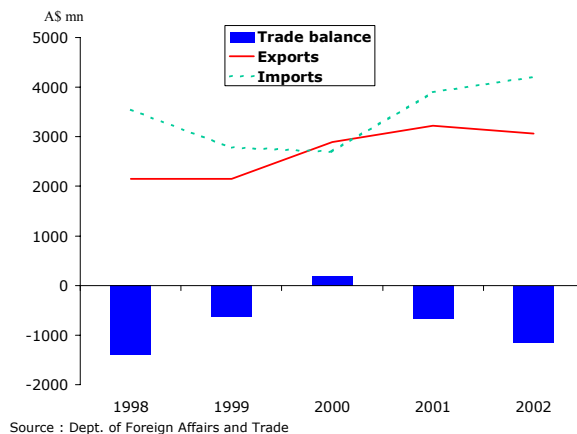
Indonesia's main sources of imports 2002



Source: IMF: Direction of Trade

Australia's trade with Indonesia

Australia's trade with Indonesia



Australia's trade with Indonesia in 2002

	% share of total
Australia's exports:	
Cotton	13.0
Live animals	8.5
Aluminium	5.5
Milk and cream	4.2
Other manufactures of base metal	2.2
Australia's imports:	
Crude petroleum	40.2
Non-monetary gold	13.7
Paper & paperboard	3.7
Refined petroleum	2.3
Furniture	2.3

Australia's exports:

Indonesia was Australia's 10th most important export market in 2002, accounting for 2.6% of total exports. Exports to Indonesia declined by 5% in 2002, following an 11.3% increase in 2001.

Australia's imports:

Indonesia was Australia's 9th most important source of imports in 2002, accounting for 3.3% of total imports. Imports from Indonesia rose by 8.1% in 2002, after a hefty 44% increase in 2001.



Australia and New Zealand Banking Group Limited is represented in:

AUSTRALIA by:

Australia and New Zealand Banking Group Limited ABN 11 005 357 522
10th Floor 100 Queen Street, Melbourne 3000, Australia
Telephone +61 3 9273 6224 Fax +61 3 9273 5711

UNITED KINGDOM by:

Australia and New Zealand Banking Group Limited
ABN 11 005 357 522
Minerva House, PO Box 7, Montague Close, London, SE1 9DH, United Kingdom
Telephone+ 44 171 378 2121 Fax+44 171 378 2378

UNITED STATES OF AMERICA by:

ANZ Securities, Inc. (Member of NASD and SIPC)
6th Floor 1177 Avenue of the Americas
New York, NY 10036, United States of America
Tel: +1 212-801-9160 Fax: +1 212-801-9163

NEW ZEALAND by:

ANZ Banking Group (New Zealand) Limited.
Level 10 215-229 Lambton Quay Wellington, New Zealand
Telephone +64 4 496 7000, Fax +64 4 496 7360

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