QUARTERLY ANALYSIS:
The Progress of Monetary, Banking and Payment System
Third Quarter - 2010

Author Team of Quarterly Report, Bank Indonesia

The acceleration of economic growth in Indonesia was still continuing and the macroeconomic stability was maintained. Accelerating economic growth was driven by the increased consumption and exports and investment. Consumption was increased by the optimism sparked by consumer confidence, availability of consumption financing and low import prices. Meanwhile, the improved export activity that remained improving was resulted from the strong demands mainly from China and India. The increasing domestic and international demand has resulted in increased investment growth. The Indonesian economy in 2010 was estimated to grow 6.0% -6.3% and in 2011 to reach 6.0% -6.5% range.

In terms of prices, inflation was recorded in high level during the third quarter of 2010. Increased rates occurred was mainly originated from volatile foods, such as various spices and vegetables. Meanwhile, core inflation pressures and administered prices were still at the low level. Bank Indonesia kept a close watch on potential inflationary pressures and improved policy coordination with the Government both at central and regional levels, and would respond with a combined of policy required to keep the inflation on target set, which was 5% ± 1% in 2010.

The global economy continued to show improvement, although not evenly. The economy of developed countries like the United States, Japan and China were slowing. In US, It was mainly due to the depressed consumption related to high unemployment and credit crunch, while Japan's economic slowdown was caused by the strengthening yen, which have an impact on export competitiveness. Previously fast-growing China now must put the brakes on economic growth to avoid overheating.

On the other hand, European countries, especially Germany and France grew better than expected. The increase was, among others, driven by rising exports and the European banking sector stress test results which was better than expected and has sparked optimism among economic actors. In addition, the economies of the emerging market countries also continued to solidly grow. Global industry that continued to expand and the volume of world trade that keep increasing have made the world economy in the third quarter of 2010 continued to grow although in a more moderate manner than the second quarter of 2010.

Domestic economic growth in the third quarter of 2010 was estimated to be better than the previous quarter. In the third quarter of 2010, the domestic economy was expected to grow 6.3% (yoy). The increase was driven by household consumption growth which was expected to remain above 5% (yoy). Consumption growth was influenced by, among others, the consumer optimism and the rising incomes from exports. The export growth in the third quarter of 2010 was expected to reach 11.4%.

Export growth was triggered by the global economic growth that continued to improve, especially in China and India along with the expanding of export destinations. Investment was expected to grow by 9.9% (yoy) in the third quarter of 2010 as a response to increasing demand and the improving investment climate. This condition implied that imports were also increased. By sector, non-tradable sector was growing faster than the tradable sector.

The improved economic development was also reflected in the economic development that continued to increase within the provinces across the nation. Regional economic growth was primarily driven by economic performance in Sumatra and eastern Indonesia (Sulawesi, Maluku, Papua - Sulampua) in the plantation and mining sub-sectors. In addition, the performance of manufacturing industry and construction sector in the region of Java, Bali, Nusa Tenggara (Jabalnustra), and Borneo also contributed significantly to economic growth.

On the demand side, regional economic growth was sustained by consumption and investment aligned with the high consumer optimism, consumption credit, and stable exchange rate of the farmers. From the investment side, the increase occurred in buildings and non-buildings investment. Investment activities in building were sufficiently high in Jakarta and Jabalnustra, especially in real estate for retail and offices. In terms of exports, the increase in manufacturing exports was mainly from Jabalnustra and DKI Jakarta. While the increase in commodity exports of natural resources came from Kalimantan, Sulawesi-Maluku-Papua (Sulampua) and Sumatra, although there was disruption of production due to weather anomalies.

In terms of prices, inflation during the third quarter of 2010 showed an increase which was mainly sourced from the volatile food. The persistently high inflationary pressure from volatile foods distribution and production due to disruption was caused by weather anomalies as well as an increase in electricity tariff for households. Meanwhile, inflationary pressure was also derived from the adjustment of educational costs in connection with the arrival of the new school year and an increase in demand related to religious holidays.

However, inflationary pressure in September 2010 noted a decrease of 0.44 (mtm), lower than the previous month set on 1.57% (mtm). With these developments, during the third quarter of 2010, CPI inflation stood at 2.79 (qtq) or reached 5.80% (yoy), higher than the previous quarter to reach 1.41% (qtq) or 5.05% (yoy). Meanwhile, the impact of the administered prices group in IHK inflation was still relatively small in the absence of government strategic policy on prices in September 2010.

Indonesia's balance of payments (Neraca pembayaran Indonesia/NPI) in the third quarter 2010 is expected to record a higher surplus than originally estimated. It is caused by the surplus capital and financial (transaksi modal dan finansial/TMF), which has improved significantly. The remarkable growth of TMF was motored by the improved international perception on Indonesia's economy, such as the improved credit rating outlook for Indonesia, the return on investment dollars that were likely to increase, and the condition of excess global liquidity.

On the other hand, the surplus of current account (CA) was expected to decline due to high import growth, in parallel with the accelerated domestic economic activity. However, the accelerated imports were still supporting the domestic economic activity, reflected by the dominance of imported raw materials and capital goods. With these developments, the national reserves at the end of September 2010 reached 86.5 billion U.S. dollars, equivalent to 6.5 months of imports and foreign debt repayments by the Government.

The rupiah continued to strengthen along with the performance of the current account that still recorded a considerably large surplus, and the rapid flow of incoming foreign capital and the risk factors that still existed. The strengthening of rupiah was supported by positive global sentiment and the domestic fundamentals which became more solid. Compared with the second quarter of 2010, on average, the rupiah was appreciated by 1.2% (qtq), reaching Rp9.001 per U.S. dollar.

The strengthening of rupiah on the third quarter was followed by the volatility fell from 0.5% in second quarter of 2010 to 0.2% in third quarter 2010. At the end of the third quarter of 2010 rupiah closed at Rp8.924 per U.S. dollar, or rose 1.2% (ptp) compared with second quarter 2010. The rupiah was stable enough to support the need for imported raw materials needed for domestic production activities, and on the other hand the strengthening of the rupiah has not given any significant pressure for exporters because of the strong international demand.

Overall, the financial market in the third quarter of 2010 was in a more stable condition over time. SUN market and capital markets conditions continued to improve as reflected in the increased Composite Stock Price Index (Index Harga Saham Gabungan/IHSG) and the decreased yield on government securities. The improvement in capital markets and securities in the third quarter of 2010 was sustained by the economic outlook continues to improve.

On the interbank money market, liquidity conditions during the third quarter of 2010 tended to increase. Transmission of monetary policy throughout the third quarter of 2010 also went well as reflected in the PUAB O/N rate which moves around the BI Rate, the increased credit growth especially for this type of working capital and the stock index that reached its highest level in history.

From the micro-banking side, national banking got stronger. This was reflected by the high capital adequacy ratio (CAR) and the maintained ratio of gross non-performing loan (NPL) under 5% addition, the liquidity of banking - including the liquidity in the interbank money market – was increasingly improved and the third party funds (TPF) continued to rise. Banking intermediation was also getting better, as reflected in credit growth, which until the end of September 2010 reached 21.2% (yoy). Growth in working capital during the year 2010 has overcome the consumption credit, and in the future the credit growth will be directed to the productive sector. With these developments and in accordance with the bank's business plan, to overall credit growth in 2010 was estimated at 22% -24%. The increase in credit was primarily driven by improved confidence of all economic actors on the economic outlook.

Based on the assessment and the economic outlook, Bank Indonesia Board of Governors Meeting on October 5, 2010 decided to maintain the BI Rate at 6.5% with interest rate corridor of ± 100 bps. The decision also considered that the level of the BI Rate at 6.5% was consistent with the medium-term inflation target and regarded conducive to maintaining financial stability and promote banking intermediation, so that the supply side could respond sufficiently the accelerated demand side.