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"The Impact on Indonesia of the Current Financial Crisis in the US"

Open Forum with

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Daniel Citrin initially examined the global financial picture, noting the deteriorating financial conditions over the past 12 months. He then focused on the financial metrics in Asia, Southeast Asia and Indonesia.

Since last October credit risks have increased sharply with increasing interest rates and a general tightening of liquidity. However, over the past two months world credit markets appear to have stabilized, but at higher levels of interest rates.

In general, emerging economies escaped largely unscathed by the subprime problems that have dogged U.S. and European economies. Asian banks had little exposure to the collateralized debt that has weighed on western financial institutions. Nevertheless, Asian equity markets have declined along with stock markets elsewhere. Sovereign spreads in the Philippines and in Indonesia remain at elevated levels

With regard to economic growth, global growth is projected to decline from 4.7% to 3.7% during the 2007 to 2009 period. Over the same period, growth among emerging economies is expected to decline from 7.9% to 6.6%. The Indonesian economy is expected to stabilize at a growth rate of approximately 6.1%-6.3%.

Asian inflation rates are anticipated to increase from 3% to 5% by 2009. However, trade is expected to remain robust.

Indonesia is reasonably well positioned to withstand moderate slowdowns in the Western economies. Its strengths include strong domestic demand, greater financial integration with other Asian countries, and expanding trade with regional partners. Its challenges involve rising inflation, burdensome energy subsidies and sagging consumer confidence. On the bright side, the current account is in surplus at 2% of GDP and monetary reserves have increased accordingly. Loan volumes are growing on a broad base.

Despite the above positive factors, many observers believe that Indonesia has underperformed its potential. Bond yields along with core inflation have increased. Real interest rates are approaching zero and the Rupiah has been weakening since 2007.
Fuel subsidies have crowded out other budgetary claims. In 2008 it is estimated that the subsidies amount to one quarter of total government spending and one half of discretionary spending.

Mr. Citrin’s conclusions on the Indonesian economy: near term is favorable with some downside risks; inflation must be tackled; and subsidies gradually adjusted downward.

Discussion

Q: What is the IMF’s assumption on energy prices?

A: The IMF does not make a formal projection but we anticipate that oil prices will remain at high levels.

Q: What is the likelihood of policy changes on the subsidies to avoid crises?

A: The government fears the reaction of poorer sectors of the population. However, it could alleviate the problem through fiscal measures. The goal should be an automatic reduction of the subsidies as prices increase.

Q: What are the prospects for greater foreign direct investment in Indonesia?

A: FDI has increased steadily over the past several years. The investment climate has improved but issues still remain.

Q: What is the unemployment outlook?

A: Unemployment is disappointingly high, currently approaching 9%. Problematic labor laws continue to inhibit job growth.