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SURVEY OF RECENT DEVELOPMENTS

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SUMMARY

Little has happened to dispel concern that reform momentum is dissipating. New National Economic and Innovation Committees to help accelerate development will probably achieve little: resolving many key economic policy issues is straightforward technically, so the real obstacle to doing so is lack of political will and leadership.

It appears that economic growth has stabilised rather than continuing to accelerate. Investment is still strong, but fiscal policy is no longer providing a stimulus. Soeharto-era attachment to small budget deficits remains evident in the 2011 budget, which persists in spending heavily on subsidies at the expense of investment in sorely needed infrastructure. The demand for net exports had temporarily constrained growth, but by Q2 2010 this was no longer the case. Manufacturing has been in the doldrums, partly because of surging export commodity prices and volumes, but its recent growth seems more promising. International reserves continue to accumulate because of the commitment of Bank Indonesia (BI) to avoiding rupiah appreciation, which makes monetary policy difficult and costly to implement. BI has responded by allowing some appreciation, an acceleration of inflation and a small increase in the interest rate on its certificates of deposit, and by forcing banks to place more funds with it at low or zero interest. At last it has begun to tighten monetary policy, but this is likely to increase capital inflow, despite the introduction of a new capital control. The incompatibility of BI's monetary and exchange rate policies will therefore continue to cause problems. Rapid rice price inflation, however, is not the fault of the central bank, but a consequence of the policy of preventing Indonesia from participating more fully in the world rice market.

Official indicators suggest that the banking sector is in good condition. One concern is that interest margins are too high, which seems to be attributable to inefficiency in government-owned banks. If pressure to prevent or roll back increased foreign ownership of Indonesian banks is successful, this is likely to make the banking system even less efficient. Indonesia continues to have difficulty competing for foreign investment with comparator countries such as Thailand, Vietnam and Brazil: much remains to be done to improve the climate for doing business. The government appears to be pondering more serious approaches to tackling the problem of Jakarta's congestion, although conflicting signals on this have emerged. Solutions are seen in expansion of transport infrastructure and improvement of its management, and in the introduction of electronic tolling on main roads.

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