



## INDONESIA: ECONOMIC AND FINANCIAL HIGHLIGHTS OCTOBER 2005

### Summary:

- The Central Statistics Bureau (BPS) announced on November 1 that consumer price inflation rose 17.9% year-on-year (YoY) in October, the highest YoY rate in six years, largely due to the fuel price hikes of October 1.
- In response, BI raised its benchmark interest rate 125 basis points to 12.25% on November 1, on top of a 100 basis points increase on October 4.
- The Government of Indonesia (GOI) concluded its 2005 bond issuance program with the sale of USD 1.5 billion in dollar-denominated global bonds on October 6, and Rp 500 billion (USD 50.1 million) in domestic, rupiah-denominated bonds on October 26.
- The GOI also bought back Rp 2.5 trillion (USD 250.5 million) in domestic bonds on October 24 (maturing in 2007-2009), and is expected to repurchase some Rp 4-5 trillion (USD 400.8 - 501 million) in November and December 2005.
- Foreign exchange reserves rose 7% to USD 32.5 billion on October 28, up from USD 30.3 billion on September 30, boosted by proceeds from the global bond sale.
- Bank Indonesia (BI) announced a hedging facility on October 3 for investors to swap dollars with rupiah.
- BI signed on October 17 a USD 2 billion currency swap agreement with the People's Bank of China under the Chiang Mai Initiative.
- Following large redemptions in the mutual fund industry -- which have lost 79% of their net asset value (NAV) since February -- the Capital Market Supervisory Authority (BAPEPAM) temporarily suspended the registration of new fixed income mutual funds effective October 7.
- The investment arm of the Malaysian Government and United Overseas Bank of Singapore acquired majority stakes in mid-sized Indonesian commercial banks in October 2005.

### October Inflation Jumps to 17.9%

On November 1, the Central Bureau of Statistics (BPS) announced that YoY consumer price inflation surged to 17.9% year-on-year (yoy) in October 2005, the highest YoY rate in six years. The driving factor behind the larger than expected increase was Indonesia's October 1 hike in subsidized fuel prices, which sparked large month-on-month increases in transportation (28.6%), housing (7.4%), and foodstuffs (7.2%). The surge in food prices reflects increased demand during the Ramadan period (October 5 – November 4) in addition to the fuel price increases. BI said it expects inflation has peaked in October 2005, and will drop back to single digits in the first half of 2006.

## **CPI Components**

<b>Components</b>	<b>YoY</b>	<b>MoM</b>
Food stuff	7.24	17.98
Food, beverages, tobacco, cigarettes	3.21	12.46
Housing, water, electricity, oil/gas	7.40	14.11
Clothing	1.84	7.71
Health	0.95	5.87
Education, recreation, and sport	1.40	8.03
Transportation, communication, financial services	28.57	44.69
<b>TOTAL</b>	<b>8.70</b>	<b>17.89</b>

*Source: Central Bureau of Statistics*

## **BI Hikes Interest Rates**

In response to rising inflation expectations, BI raised interest rates on its benchmark one-month certificates (SBI) 125 basis points to 12.25% on November 1. The increase in the BI rate was the fourth in six weeks, or 485 basis points since the start of the year. Following the steep increase in transportation costs in the wake of October 1st fuel price hikes, BI raised its overall inflation rate forecast to 14% for 4Q 2005. BI expects a 2005 annual GDP growth rate of 5.5 – 6%.

## **GOI Wraps Up Bond Issuances for 2005**

On October 6, the GOI sold USD 1.5 billion in dollar-denominated global bonds comprised of USD 900 million in 10-year bonds at a yield of 7.6% and USD 600 million in 30-year bonds at a yield of 8.6%. The 10-year and 30-year bonds have a spread of 3.3% and 4.1% respectively over comparable US treasuries. Reuters noted that Indonesia's second and final international bond issuance of the year came "as risk premiums in emerging-market debt are at near-record lows, opening up avenues of cheap funding for companies and governments alike." Finance Minister Jusuf Anwar said the Ministry of Finance (MOF) would use the proceeds to finance the state budget deficit as well as strengthen Indonesia's foreign exchange reserves. The GOI has now surpassed its annual bond issuance target of Rp 43.3 trillion (USD 4.3 billion), with the total for 2005 at Rp 46.5 trillion (USD 4.7 billion). On October 26, the government concluded its domestic bond issuance program for 2005 with the sale of Rp 500 billion (USD 50.1 million) of 15-year bonds at yield of 14.6%.

## **Government Bond Buybacks**

On October 24, the GOI bought back Rp 2.5 trillion (USD 250.5 million) worth of high-interest government bonds maturing in 2007 - 2009. The government has an overall goal to buy back a total of Rp 80 trillion (USD 8 billion) of bonds maturing in 2007-2009. Thus far, it has purchased Rp 3.4 trillion (USD 340.7 million). The Director General for State Treasury Mulia Nasution said the government plans to buy back or refinance an

additional Rp 4-5 trillion (USD 400.8 – 501 million) by the end of this year. Nasution said he hoped GOI could finish the year with a surplus of Rp 800 billion (USD 80.2 million) from bond sale proceeds. BI has also purchased government bonds in recent months.

### **FX Reserves Rise**

BI said its foreign exchange reserves rose seven percent to USD 32.5 billion as of October 28 from USD 30.3 billion on September 30, boosted by proceeds from the government's October USD 1.5 billion global bond sale.

### **BI Announces Hedging Facility, Swap Agreement**

BI announced on October 18 it will now serve as the counterparty of last resort for investors seeking protection against rupiah volatility. In addition to conducting one- to seven-day currency swaps to smooth the rupiah market, it announced a hedging facility on October 3 for investors to swap dollars into rupiah and back for three- to six-month periods. BI suspended this practice after the 1997-98 financial crisis and is only now reintroducing it.

On October 17, BI signed a currency swap agreement with the People's Bank of China allowing BI to receive up to USD 2 billion from China if it needs short-term funds. The agreement is one of several such swap agreements under the Chiang Mai Initiative, set up by the ten member countries of the Association of Southeast Asian Nations (ASEAN) and Japan, China and South Korea in the wake of the 1997-1998 Asian financial crisis. Under the initiative, the member nations agreed to a network of bilateral currency swap agreements to provide an emergency pool of funds in case of another crisis. China and Indonesia signed a USD 1 billion currency swap agreement in December 2003. In May, finance ministers from the ten ASEAN countries, Japan, China and South Korea agreed to increase the size of their USD 39.5 billion currency swap program, and have since been negotiating bilateral terms.

### **Limits on New Fixed Income Mutual Funds**

Effective October 7, Capital Markets Supervisory Authority (BAPEPAM) Chairman Darmin Nasution announced that his agency had decided to temporarily close the registration of new fixed income mutual funds. BAPEPAM explained that the policy is in response to the large number of redemptions in the industry, with some funds losing 70-90% of their investors in 2005. BAPEPAM is also reviewing the regulations relating to fixed income transactions, especially in the secondary market, to improve liquidity and transparency. BAPEPAM's Head of Investment Management and Research Freddy Saragih said it would re-evaluate the policy after it finishes its review. Total NAV of the mutual funds industry dropped significantly from Rp 110.6 trillion (USD 11.1 billion) in February 2005 to approximately Rp 34.9 trillion (USD 3.5 billion) in September 2005. Fixed income mutual funds suffered the greatest redemptions, falling from Rp 92.3 trillion (USD 9.2 billion) to Rp 19.1 trillion (USD 1.9 billion) or 79% within the same

period. Most mutual funds in Indonesia invest heavily in domestic government bonds. Indonesia's secondary market for corporate bonds is still small and fairly illiquid, though many are investment grade.

### **Malaysia's Investment Company Buys Bank Niaga**

On October 6, Malaysia's state investment arm Khazanah Nasional completed the acquisition of a 52.05% stake in Indonesia's Bank Lippo. Khazanah said that its wholly-owned subsidiary, Amsterdam-based Santubong Investments, bought the stake from the Swissasia Global consortium for approximately Rp 3.3 trillion (USD 330.7 million). With the 52.05% stake, Santubong is now the controlling shareholder of Bank Lippo. Swissasia paid Rp 1.2 trillion (USD 120.2 million) for the shares in 2003 from the now defunct Indonesian Bank Restructuring Agency. Bank Lippo shareholders approved Khazanah's takeover in August. Bank Lippo has access to over 2.8 million customers and a strong track record of customer service and innovation. The bank is listed on the Jakarta Stock Exchange and is Indonesia's ninth largest bank in terms of assets as of December 2004.

### **UOB Completes Bank Buana Stake Increase**

On October 14 the United Overseas Bank's wholly-owned subsidiary UOB International Investment Private Ltd (UOBII) announced it has completed the acquisition of an additional 30% of Indonesia's Bank Buana. The acquisition increases UOBII's stake in Bank Buana from 23% to 53%, making Buana a UOB subsidiary. The total value of the shares was Rp 1.65 trillion (USD 165.3 million), which is 2.59 times unaudited book value of Bank Buana as of June 30. Its net tangible assets during the same period was Rp 2.1 trillion (USD 210.4 million).

### **Selected Economic, Monetary & Financial Statistics**

	Jun 05	Jul 05	Aug 05	Sep 05
CPI Inflation (YoY)	7.42	7.84	8.33	9.06
CPI Inflation (MoM)	0.50	0.78	0.55	0.69
Rp/USD Exchange rate <sup>1</sup>	9,713	9,819	10,350	10,290
30-day SBI Interest Rate <sup>2</sup>	8.25	8.49	9.51	10.00
Foreign reserves <sup>3</sup>	33.86	32.10	32.02	31.20
JSX Composite Index	1122.4	1182.3	1050.1	1079.3
JSX Trans Volume <sup>4</sup>	1,209	1,657	1,958	
Exports (USD billion)	6.73	6.99	7.03	
% Change (YoY)	27.48	25.85	23.94	
Import (USD billion)	4.72	4.82	5.40	
% Change (YoY)	35.35	31.89	32.22	
Trade Balance <sup>5</sup>	2.01	2.17	1.63	

Source: Bank Indonesia, BPS

(1) Rp/USD, end of period

(2) End of period

(3) *USD billions, end of period*

(4) *Jakarta Stock Exchange average daily transaction volume, in billions of shares*

(5) *USD billions*

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