
RATING PERSPECTIVE

Republic of Indonesia

Growing political and economic stability

More than 10 years have passed since the Republic of Indonesia (hereinafter called "Indonesia") experienced political and economic turmoil in the late 1990s when it underwent a series of shocks such as the Asian currency crisis, riots in Jakarta and the resignation of then President Suharto. Thus far, Indonesia has been regaining political and economic stability. On the political front, democracy has settled and the separatist and independence movements have largely calmed down. On the economic front, it has been achieving steady economic growth, having significantly reduced the size and the burden of its public and external debt.

When the world plunged into the financial and economic crisis after September 2008, Indonesia also faced a sharp depreciation of its currency rupiah which fell by nearly 40% at one time. Nevertheless, its impact on the financial system and the real economy was contained marginal, in sharp contrast to the Asian currency crisis a decade ago. When most of other Asian economies suffered from economic contraction, Indonesia maintained positive real GDP growth. In 2009, it carried out general and presidential elections successfully, impressing the world with its solid and stabilized democratic political system.

Based upon such development, JCR, on July 7, 2009, upgraded its ratings on Indonesia's foreign currency long-term senior debts to BB+ from BB and those on its local currency long-term senior debts to BBB- from BB+. In this International Report, Indonesia will be focused, particularly on its increasing political and economic stability, together with JCR's viewpoints and future perspectives of its ratings.

1. Establishment of democratic political system and growing political stability

1.1 Establishment of democratic political system under the post-Suharto regime

In May 1998, then President Suharto resigned from his office after 32 years in power, and B.J. Habibie, the then Vice President, was inaugurated as the third President of Indonesia. President Habibie carried out wide-ranging reform policies to promote democracy and decentralization including liberalization of forming political parties, and called a general election in 1999. As a result, Abdurrahman Wahid, head of the National Awakening Party (PKB), became the fourth President, who was subsequently impeached in 2001 and succeeded by Megawati Soekarnoputri, head of the Indonesian Democratic Party-Struggle (PDI-P). In August 2008, the Constitution was amended by which the basic framework of the current democratic political system was formed, such as direct election of President and Vice President, bicameral

parliament system consisting of the House of People's Representatives (DPR) and the Regional Representatives' Council (DPD), and abolishment of the parliament seat allocation to the military.

Following the general and presidential elections in 2004, Susilo Bambang Yudhoyono, leader of the then fourth largest Indonesian Democratic Party (PD), a veteran, and a former Coordinating Minister for Political and Security Affairs, became the sixth President of Indonesia. His administration, in the early days, encountered a series of disasters such as the earthquake in Sumatra (December 2004), Bali terror attack (November 2005), and an outbreak and spread of bird flu (H5N1). However, the Yudhoyono government afterwards gained strong public support, having successfully carried out the settlement of Aceh independence movement (the peace agreement was signed in August 2008 with the armed guerrilla force called Aceh Independence Movement (GAM)), an improvement of fiscal structure by raising administered fuel prices while providing subsidies targeted at the poor (March and December 2005), and combating against corruption and terrorism. Yudhoyono's economic team, led by Boediono, Coordinating Minister for Economic Affairs (who later became the governor of the central bank, and was subsequently elected as Vice President in July 2009), and Sri Mulyani Indrawati, Finance Minister, has also made a steady economic management, gaining strong confidence among the international community.

1.2 Enhanced political stability through the general and presidential elections in 2009

In 2009, the general and presidential elections took place in April and July, respectively. In the general election, 11,215 people from 44 political parties ran for the 560 DPR seats, and nine political parties gained seats. PD, which President Susilo Bambang Yudhoyono belongs to, won 148 seats, accounting for 26% of the total. In the following presidential election, incumbent President Yudhoyono, a candidate from PD, was re-elected. The second Yudhoyono government is going to start from October 2009, in which Yudhoyono and Boediono will assume the offices of President and Vice President.

As a result of the general election in April 2009, the combined share of the seats of the PD led coalition including four Islamic parties such as the Prosperous Justice Party (PKS) reaches 57% in the DPR (of which the PD holds 26% of the total). Furthermore, there is an observation that some members of the Golkar Party, the second largest party, and the Indonesian Democratic Party of Struggle (PDI-P), the third largest, are showing an intention to approach PD

1. Indonesian politics: Key political parties and key figures

Political party	Key person		2009 election		Past elections	
			Seats	Share	2004	1999
Democratic Party (PD)	Susilo Bambang Yudhoyono (SBY), President	Secular. Established in 2001 to support SBY.	148	26%	55	-
Golkar Party	Jusuf Kalla, Vice President	Secular. Established in 1964. Ruling party during Suhart regime.	106	19%	128	120
Indonesian Democratic Party - Struggle (PDI-P)	Megawati Sukarnoputri, former President	Secular. Established in 1998. Popular in Java and Bali.	94	17%	109	153
Prosperous Justice Party (PKS)	Hidayat Nur Wahid, Speaker of MPR	Islam. Established in 1998. Supported by urban young generation.	57	10%	45	7
National Mandate Party (PAN)	Amien Rais, former Speaker of MPR	Moderate Islam. Established in 1998. Backed by an Islamic organization Muhammadiyah.	46	8%	53	34
United Development Party (PPP)	Hamzah Haz, former Vice President	Islam. Established in 1973.	38	7%	58	58
National Awakening Party (PKB)	Abdurrahman Wahid, former President	Islam. Established in 1999. Backed by conservative Muslim organization Nahdlatul Ulama.	28	5%	52	51
Great Indonesia Movement Party (Gerindra)	Prabowo Subianto, former Indonesian special forces commander	Secular. Established in 2008 to support Prabowo.	25	4%	-	-
People's Conscience Party (Hanura)	Wiranto, former Indonesian Military commander	Secular. Established in 2006 to support Wiranto, a indicted war criminal.	18	3%	-	-
Total			560	100%	550	500

Compiled by JCR based on various news and reports including JCIF's

despite rivalry during the election, which may potentially enhance the ruling coalition parties further. Although the coalition partners' cooperation to the PD may depend upon each policy issue, the political base of the second Yudhoyono government is expected to be more solid than his first government when PD held a mere 10% of DPR seats.

Thus, Indonesia has enhanced political stability through the 2009 general and presidential elections under a democratic political system. President Yudhoyono and Vice President Boediono made election pledges that, with an aim of achieving sustainable economic growth, they would devote themselves in developing infrastructure and improving the investment environment. Under the enhanced political base, there are high expectations for those to be materialized.

2. Sustained economic growth

2.1 Indonesian economy embracing large domestic demand

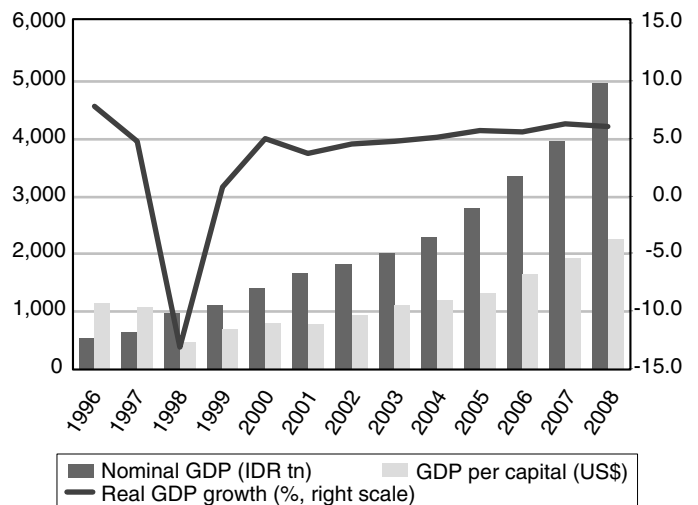
Indonesia is the largest country in the Southeast Asia, with an area of approximately 1.89 million square kilometers (about four times the size of Japan) and a population of 229 million. In 2008, its gross domestic product (GDP) reached 4,954 trillion rupiah (approximately US\$510.8 billion, 52.8 trillion yen) and its GDP per capita rose to US\$2,235, having achieved steady economic growth since the Asian currency crisis.

Indonesian economy has the following characteristics especially in comparison to the neighboring ASEAN countries such as Singapore, Malaysia and Thailand: (1) largest in terms of population and the economic size; (2) relatively lower level of GDP per capita; (3) smaller exports (gross and net) and larger domestic private consumption in terms of the

2. Policies pledged by new President and vice-President

Susilo Bambang Yudhoyono (SBY), President	Economic growth - 7% by 2014 Inflation - 6% by 2014 Decline in poverty rate and improvement of social welfare Strengthening of tax compliance Improvement in administrative procedures
Boediono, Vice President	Development of physical infrastructure (e.g., road, bridge, power, port, railway) Development of soft infrastructure (e.g., business environment) Poverty reduction

3. GDP trend



Source: BPS

RATING PERSPECTIVE

ratio to GDP; (4) relatively limited accumulated stock of foreign direct investment (FDI); and (5) comparable level of the ratio of public and external debt to GDP.

2.2 Challenges: Improvement of investment environment especially the infrastructural development

Indonesia's relatively limited openness characterized by the smaller shares of export and FDI stock to the economic size in comparison with the neighboring countries may derive

from the fact that the country has received relatively smaller incoming FDI by multinational manufacturing companies forming production and distribution networks in East Asia. This may attribute to the fact that it has a large domestic market of over 2 hundred million populations and is a country of archipelago that requires extensive infrastructure such as ports and roads.

Japan Bank for International Cooperation (JBIC) issues "Survey Report on Overseas Business Operations by Japa-

4. Major ASEAN countries

[CY2008]		Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam
Nominal GDP	US\$ bn	510.8	222.2	168.6	181.9	273.2	91.3
Population	mn	237.5	27.7	92.7	4.8	67.0	86.1
GDP per capita	US\$	2,150	8,014	1,820	37,597	4,080	1,060
Private consumption	% of GDP	60.9	45.1	70.4	41.0	54.8	64.7
Export (gross)	% of GDP	29.8	103.5	38.0	234.3	76.4	79.3
Export (net)	% of GDP	1.1	23.2	-0.2	19.1	2.8	-13.9
Public debt	% of GDP	28.5	41.4	56.3	99.2	37.1	45.2
Export	US\$ bn	136.9	199.5	49.0	338.1	176.0	61.2
Inward FDI stock	US\$ bn	67.3	83.4	21.4	248.2	102.9	40.3
Foreign reserves	US\$ bn	51.6	91.2	37.6	174.2	111.0	22.7
External debt	% of GDP	27.5	22.7	36.4	14.0	22.5	25.3

Source: EIU

5. Investment climate

Prospective FDI destinations over medium term	2004	2005	2006	2007	2008		
No.1	China	China	China	China	China		
No.2	Thailand	India	India	India	India		
No.3	India	Thailand	Vietnam	Vietnam	Vietnam		
No.4	Vietnam	Vietnam	Thailand	Thailand	Russia		
No.5	USA	USA	USA	USA	Thailand		
No.6	Russia	Russia	Russia	USA	Brazil		
No.7	Indonesia	Korea	Brazil	Brazil	USA		
No.8	Korea	Indonesia	Korea	Indonesia	Indonesia		
No.9	Taiwan	Brazil	Indonesia	Korea	Korea		
No.10	Malaysia	Taiwan	Taiwan	Taiwan	Taiwan		
	China (No.1)	India (No.2)	Vietnam (No.3)	Russia (No.4)	Thailand (No.5)	Average (No.1-5)	Indonesia
Attractions (+ for ID)							
Cheap labor	44.9	38.7	61.3	5.4	38.7	37.8	56.1
Growth potential of local market	77.6	84.4	48.0	86.8	47.6	68.9	65.9
Current size of local market	37.1	16.4	6.0	20.9	25.8	21.2	39.0
Challenges (+ for ID)							
FX conversion and transfer risk	32.3	6.6	10.4	10.8	6.0	13.2	2.4
Complicated investment permit	24.2	13.6	4.6	22.5	6.0	16.2	7.3
Taxation	29.8	6.2	2.1	5.0	11.1	10.8	7.3
Attractions (- for ID)							
Preferred tax treatment	6.5	1.5	12.0	2.3	16.1	7.7	2.4
Industrial conglomeration	15.6	5.2	3.3	1.6	23.4	9.8	4.9
Skillful labor	13.9	25.3	28.0	1.6	21.8	18.1	12.2
Challenges (- for ID)							
Underdeveloped infrastructure	26.0	52.1	43.1	23.3	10.3	31.0	36.6
Instable social order	18.9	17.5	6.3	26.7	13.7	16.6	34.1
Rising labor cost	63.9	21.0	24.3	18.3	36.8	32.9	29.3

Source: Japan Bank for International Cooperation

nese Manufacturing Companies" annually. Indonesia, in recent years, has been ranked eighth as the "Medium Term Prospects for Overseas Operations," lower than Vietnam and Thailand. The latest report indicates that Indonesia is "attractive" in cheap labor and large local market while "challenging" in underdeveloped infrastructure and instable social order. This also shows that Japanese FDI has been focused on those oriented for domestic demand (rather than export-oriented), given the challenges of underdeveloped

infrastructure.

On the underdeveloped infrastructure, the survey published by JETRO Jakarta Center also reveals that local Japanese companies consider the followings the urgent issues to be addressed: (a) chronic traffic congestion in Jakarta; (b) poor transportation network including roads, ports and inter-city railways that are adding up logistic costs; (c) stable power supply. The power shortage is a serious issue, especially during the dry season when there occur frequent

6. Real GDP growth

	2001	2002	2003	2004	2005	2006	2007	2008
	(growth, %)							
Real GDP growth	3.6	4.5	4.8	5.0	5.7	5.5	6.3	6.1
Domestic demand	5.0	2.4	6.0	5.4	6.3	3.2	4.1	7.7
Consumption	3.9	4.7	4.6	4.9	4.3	3.9	4.9	5.9
Private consumption	3.5	3.8	3.9	5.0	4.0	3.2	5.0	5.3
Government consumption	7.6	13.0	10.0	4.0	6.6	9.6	3.9	10.4
Gross fixed capital formation	6.5	4.7	0.6	14.7	10.9	2.6	9.4	11.7
Stock	25.7	-68.7	251.5	-45.4	33.5	-13.4	-100.8	-1,690.1
External demand	-9.6	8.9	18.6	-19.5	12.0	12.8	6.8	7.3
Exports	0.6	-1.2	5.9	13.5	16.6	9.4	8.5	9.5
Imports	4.2	-4.2	1.6	26.7	17.8	8.6	9.0	10.0
	(contribution, %)							
Domestic expenditure	4.6	2.2	5.4	4.9	5.7	3.0	3.7	6.7
Consumption	2.6	3.2	3.1	3.3	2.9	2.6	3.2	3.9
Gross fixed capital formation	1.9	-1.0	2.3	1.6	2.8	0.3	0.5	2.8
Net exports	-1.0	0.8	1.8	-2.1	1.0	1.1	0.6	0.7
Statistical Discrepancy	0.1	1.5	-2.4	2.3	-1.0	1.4	1.9	-1.4

Source: BPS

7. Economic indicators

		2008						2009						
		Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Exports	%	34.1	24.8	29.9	29.0	4.7	-1.8	-18.7	-35.0	-32.3	-28.3	-22.6	-28.3	n.a.
do. (volume)	%	19.4	-7.0	-2.4	1.2	2.0	-9.8	-18.0	-24.1	-36.4	-20.6	-16.3	n.a.	n.a.
Imports	%	101.3	102.3	78.2	66.3	70.7	16.1	13.2	-31.3	-39.7	-36.2	-42.4	-32.7	n.a.
do. (volume)	%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-23.2	-40.3	-28.9	-27.1	n.a.	n.a.
Retail sales survey	point	177.9	184.8	185.5	192.2	160.4	154.6	162.3	152.6	148.1	165.8	171.1	178.9	n.a.
do. (% , yoy)	%	7.4	6.5	13.7	3.2	-15.5	-26.3	-5.0	2.9	-8.2	5.9	3.6	4.3	n.a.
Motor cycle sales	ths	543.9	577.8	612.0	559.6	515.1	493.2	402.8	367.7	414.6	435.9	385.8	457.7	485.2
do. (% , yoy)	%	46.9	58.6	43.3	17.3	22.0	1.3	2.4	-22.3	-10.8	-10.8	-28.9	-15.6	-10.8
do. (% , on a year before)	%	58.4	56.0	39.0	13.3	49.5	-5.9	-9.0	7.3	18.9	19.8	22.5	21.6	31.0
Motor vehicle sales	ths	54.0	60.4	58.2	54.6	54.7	46.1	39.6	31.6	34.4	33.8	34.3	35.4	n.a.
do. (% , yoy)	%	37.0	57.5	40.8	33.6	76.1	1.0	1.8	-23.2	-27.1	-26.9	-33.2	-29.7	n.a.
do. (% , on a year before)	%	119.8	175.7	107.5	59.7	163.7	38.6	26.8	17.6	45.4	-0.1	-2.6	-7.6	n.a.
Consumer confidence index (current)	point	72.9	72.9	80.8	83.7	85.8	84.0	78.4	79.7	82.7	86.2	88.2	91.0	94.5
do. (% , yoy)	%	-14.1	-14.7	-6.6	-1.9	-2.8	-7.2	-13.8	-7.3	0.2	6.7	10.9	15.5	29.6
Consumer confidence index (expectation)	point	85.2	91.3	97.8	103.2	103.7	108.7	102.9	105.9	110.0	111.0	116.8	120.9	123.7
do. (% , yoy)	%	-20.1	-14.8	-10.8	-4.5	-7.6	-2.9	-4.0	2.8	7.6	12.1	24.1	40.6	45.2
Electricity consumption (% , yoy)	%	7.1	7.0	7.0	6.0	0.9	8.6	0.6	-1.9	-0.8	0.5	3.9	n.a.	n.a.
Industrial production index	point	128.1	131.4	131.8	129.6	127.0	127.5	125.3	124.2	124.4	125.0	126.7	129.5	n.a.
do. (% , yoy)	%	2.4	2.8	2.9	-0.8	6.1	0.6	-1.9	-1.7	0.9	1.3	1.5	1.8	n.a.

Source: CEIC

RATING PERSPECTIVE

power cut. The Indonesian government was even compelled to issue a Ministerial Decree to shift the operation dates of manufacturing industries from weekdays to weekends in July 2008. Hence, the development of infrastructures is a critical policy agenda to enhance its long-term growth potential.

2.3 Sustained economic growth on solid and increasing domestic demands

After the Indonesian economy contracted by 13.1% in 1998 due to the Asian currency crisis, it has sustained the economic growth ranging between 3% and 5% from 2001 to 2003 and between 5% and 7% from 2004 to 2008. The growth has been continuously underpinned by domestic consumption that has steadily expanded by around 3%.

As a consequence of the global demand contraction prompted by "Lehman Shock" in September 2008, Indonesia also suffered from double-digit contraction (y-o-y) in its exports after December 2008. Nevertheless, its domestic consumption, accounting for 70% of GDP, has been resilient on the back of "special demand" associated with the general and presidential elections, increased purchasing power resulting from subsided inflation and lowered interest rates, and fiscal stimulus packages (such as tax reductions, special household allowances and civil servants' wage raises). Thus, its real GDP recorded the positive growth of 5.2% and 4.4% (y-o-y) in the fourth quarter of 2008 and the first quarter of 2009, respectively, even when the global crisis deepened.

Looking ahead, a slowdown in real GDP growth seems inevitable in the year 2009, as compared to 6.1% growth in 2008, since it dropped from 6.2-6.4% in the first three quarters of 2008 to 5.2% in the fourth quarter of 2008 and further to 4.4% in the first quarter of 2009. Nevertheless, the growth rate in 2009 should remain positive, albeit slower, given the resilient consumption as evidenced by the booming consumer confidence index that recorded all time high in June 2009.

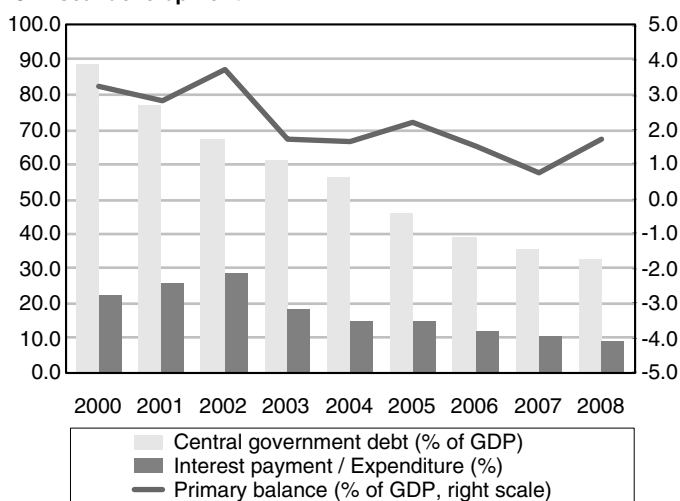
3. Prudent fiscal management and significantly reduced public debt burden

3.1 Prudent fiscal management and reduced debt burden

Indonesia has a fiscal disciplinary framework to contain the budget deficit and the combined central and local government debt to the levels below 3% and 60% of GDP, respectively, as defined by the State Finance Act (No. 17/2003). Based on that, the government has maintained a prudent fiscal management to keep the primary fiscal balance surplus, which led to sharp decline in its central government debt/GDP ratio from 88% at the end of 2000, 56% at the end of 2004, to 33% at the end of 2008. Likewise, the ratio of interest payments in the total expenditure fell from 23% in fiscal 2000, 15% in fiscal 2004 to 9% in fiscal 2008. The country's fiscal debt burden has declined considerably.

In 2009, the country's fiscal deficit is expected to expand to 2.5% of GDP and its primary balance will turn deficit, so

8. Fiscal development



Source: Indonesia MOF

9. Central government debt

Bonds (as of May 19, 2009)	Outstanding	% of GDP*
Rupiah denominated bonds		
Zero coupon bonds	IDR bn	33,173
Fixed rate bonds	IDR bn	366,873
Variable rate bonds	IDR bn	145,931
Syariah securities	IDR bn	10,256
Non-tradable bonds	IDR bn	258,480
Sub-total	IDR bn	814,713
FX denominated bonds		
Fixed rate bonds	US\$ mn	14,200
Syariah securities	US\$ mn	650
Sub-total	US\$ mn	14,850
do.(iin IDR †)	IDR bn	153,846
Total	IDR bn	968,559
		186
External loans (as of Mar 31, 2009)		
Bilateral	US\$ bn	42.4
Multilateral	US\$ bn	18.8
Commercial etc.	US\$ bn	2.0
Total	US\$ bn	63.2
do.(†)	IDR bn	654,856
		126
Grand Total	IDR bn	1,623,414
		312

Source: Indonesia MOF

* % of nominal GDP for Q1/2009 † Converted at 10,360 IDR/US\$

as to cope with the economic slowdown. Even so, as the economic growth remain positive and the central government's implicit interest rates on its debt is kept fairly low given that 40% of the central government debt consists of concessionary foreign aid, its impact on the debt sustainability should remain marginal. As the government intends to curtail its budget deficit to 1.3% of GDP in fiscal 2010, the prudent fiscal stance is expected to continue in the medium-term.

3.2 Limited impact of rising oil prices on the country's fiscal position

In Indonesia, the retail prices of some of the oil products, such as kerosene, diesel oil and gasoline, are administered by the government, for which the difference from the international prices are subsidized by the treasury. As the domestic retail prices are not adjusted according to the changes in international prices automatically, the swings in oil prices affect the government's fiscal position to a certain degree.

Nevertheless, Indonesia, being an oil producing country, could also benefit from rises in oil prices through increases in tax and non-tax revenues such as loyalty. Therefore, the net impact from the oil price fluctuation on the fiscal balance remains limited. According to the estimates by Indonesia's Ministry of Finance, an increase of oil price by US\$ 50 per barrel should only deteriorate the fiscal balance by 0.08% of GDP for the 2009 revised budget.

3.3 Prudent and precautionary budget financing

The outstanding balance of rupiah-denominated government bonds declined from 46.4% of GDP at the end of 2000 to 15.8% at the end of 2008. During the same period, the share of credit extended to the government in money supply (M2) dropped to 20.1% at the end of 2008 from 69.7% at the end of 2000. As such, the burden of the government bonds in the domestic financial system has substantially decreased. As the government maintains the primary balance surplus, no structural difficulty is observed for issuing domestic bonds.

10. FY2009 Budget and Fiscal stimulus packages

	FY2009	
	Original	Adjusted
Revenue	985.7	848.6
Tax revenue	725.8	661.8
Expenditure	1,037.1	988.1
Central government	716.4	685.0
Local government transfer	320.7	303.1
Budget balance	-51.3	-139.5
do. (% of GDP)	-1.0	-2.5
Financing	51.3	139.5
Domestic financing	60.8	109.5
Foreign financing	-9.4	-14.5
Additional financing		44.5
(Assumption)		
Real GDP growth	6	4.0 ~ 4.5
Inflation	6.2	5.5
Forex (IDR/US\$)	9,400	11,000
Oil prices	80	45 ~ 60

Source: Indonesia MOF

Fiscal stimulus package for FY2009

- Accelerate job creation and foster small scale businesses
Additional people's empowerment program
Expansion of credit program for primary sectors
Additional infrastructure projects for job creation
- Boosting the society's purchasing power
Subsidies on medicine and cooking oil
Direct subsidies for low-income households
Provide more subsidies to education and health sector
- Stimulate trade and promote entrepreneurships
Import duty facility on selected capital goods and materials
Export financing and guarantee
Tax rate reduction on corporate and individual income
Discount on electricity peak-hour charge and diesel fuel price

Concrete expenditures	US\$ bn
Tax-saving payment	3.9
Import duty & Tax subsidies for business	1.2
Non-tax subsidies for business	1.5
Total	6.7

11. Fiscal sensitivity

		Real GDP growth	Inflation	Interest rate	Forex	Oil prices	Oil production
		+1%	+1%	+1%	+1000 Rp/US\$	+10 US\$/B	+30,000 B/D
Budget balance	IDR tn	11.5	1.8	-1.5	-12.7	0.9	6.9
	% of GDP	0.2%	0.0%	0.0%	-0.2%	0.0%	0.1%
Budget financing	IDR tn	11.5	1.8	-1.5	-16.4	0.9	6.9
	% of GDP	0.2%	0.0%	0.0%	-0.3%	0.0%	0.1%
Impact of oil prices change		Oil prices (US\$/Barrel)	Fuel subsidies IDR tn	% of GDP	Budget balance *		
	Revised FY2009 Budget	52.5	24.5	0.4	-139.5	-2.5	
	Oil prices + 10\$	62.5	39.1	0.7	-140.4	-2.6	
	Oil prices +50\$	102.5	97.5	1.8	-144.0	-2.6	

Source: Indonesia MOF * Net impact is limited as not only fuel subsidies but also oil related revenues increase.

RATING PERSPECTIVE

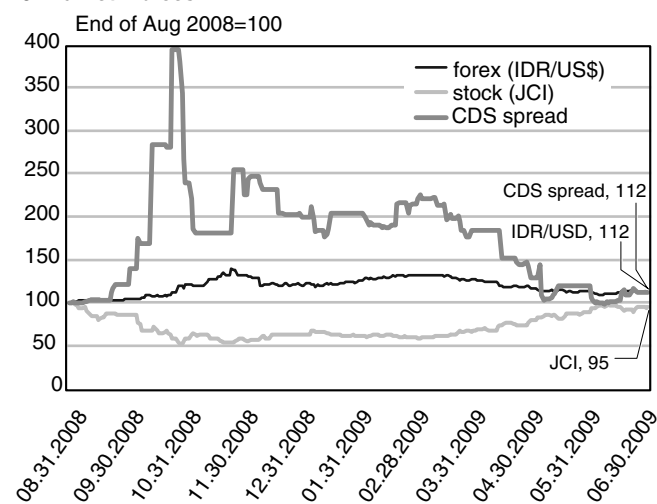
12. Budget financing for FY2009

	FY2009 Budget		
	Original	Adjusted	
	IDR tn	IDR tn	% of GDP
Budget balance	-51.3	-139.5	-2.5
Financing needs	51.3	139.5	2.5
Domestic financing	60.8	109.5	2.0
Government securities	54.7	54.7	1.0
Issuance (a)	99.6	97.7	1.8
Redemption	-44.9	-42.9	-0.8
Privatization and asset sales	3.1	3.1	0.1
Others (incl. carry over)	3.0	51.7	0.9
Foreign financing	-9.5	-14.5	-0.3
Loan	52.2	57.6	1.1
o/w Program loan (b)	26.4	31.9	0.6
Repayment	-61.6	-72.1	-1.3
Additional needs (c)		44.5	0.8
Government securities issuance needs (a)+(c)		142.2	2.6
Gross financing needs (a)+(b)+(c)		174.1	3.2
Realization (by the end of May 2009)			
International bonds		36.1	
International sukuk		7.0	
Government securities		43.7	
Domestic & Retail sukuk		7.1	
Total realization		93.8	1.7
do. (% of (a) + (c))			66%
do. (% of (a) + (b) + (c))			54%
Remaining financing needs		80.3	1.5
(cf)			
Contingent Facility (WB, ADB, Australia, Japan)		55.0	
Remaining needs – Contingent Facility		25.3	0.5

Source: Indonesia MOF

The Indonesian government, facing deteriorating market conditions amid the global financial crisis since the fourth quarter of 2008, has been taking cautious and preemptive stance to the budget financing. Out of 174 trillion rupiah (3.2% of GDP) of its gross financing needs on the revised budget 2009 (excluding the external borrowing through project loans and the sale of state assets), 94 trillion rupiah was raised by the end of May 2009 through proactive issuances of global bonds and Sukuks. In addition, the government has secured the commitment worth US\$5.5 billion (approximately 55 trillion rupiah) in contingent facilities from the World Bank, the Asian Development Bank, Japan and Australia, which can be tapped when the country faces difficulties in raising funds from the market. As a result, the remaining balance of the financing needs is as small as 25 trillion rupiah (0.5% of GDP). It is, therefore, highly unlikely that the government will face difficulties in financing the 2009 budget, especially when the market seems to be stabilizing.

13. Market indices



Source: Bloomberg

4. Strengthened resilience against short-term external shocks, proved by the recent global financial crisis

4.1 Impact of the global financial crisis and the government's response

Indonesia was also hit by the global financial crisis after September 2008. In the fourth quarter of 2008, the portfolio investment by non-residents recorded a net outflow of US\$3.9 billion, on account of the global trend to reduce risk assets and secure liquidity on hand. This led to the deficit in its capital and financial account and its balance of payments at US\$4.1 billion and US\$4.2 billion, respectively. The rupiah fell to 12,700 per US dollar on November 24, 2008, a 39% decline from the level at the end of August 2008. The CDS spread rose to 1,236 bps on October 24, 2008, quadruple the level at the above date. The share prices (Jakarta Composite Index (JCI)) fell significantly to 1,111 on October 28, 2008, a 49% fall from the level at the same date. Also the country's official foreign exchange reserves plunged to US\$50.2 billion at the end of November 2008, from US\$58.4 billion at the end of August in the same year.

The government and the central bank, since October 2008, took a series of emergency measures to cope with the crisis such as raising its deposit protection limit, providing foreign currency liquidity to commercial banks, establishing a legal framework for dealing with failed banks, and strengthening the foreign exchange regulations to enforce the evidence of real demand.

4.2 Strengthened resilience to external shocks proved during the financial crisis

Indonesia's external debt declined from 86% of GDP and 217% of exports at the end of 2000 to 29% and 107% at the end of 2008. Also, majority of the private sector external debt were owed by foreign companies or joint ventures with foreign companies. As such, the external borrowing actually

recorded a net inflow of US\$1.97 billion even in the fourth quarter of 2008. Furthermore, In addition, the official foreign exchange reserves had climbed to US\$58.4 billion at the end of August 2008 from US\$29.4 billion at the end of 2000.

These structural improvements and the measures taken by the authorities helped Indonesia avoid, this time, the vicious cycle it experienced at the time of the Asian currency crisis in the late 1990s. At that time, sharp depreciation of the foreign exchange rate damaged the balance sheets of the corporate sector that had been widely dependent on the external borrowing. This, in turn, impaired the banks' assets, triggering the financial crisis. The dysfunctional banking system caused the serious economic crisis. However, in the fourth quarter of 2008 when Indonesia faced the external shock, this did not recur. The non-performing loans ratio in the banking sector (on a gross basis) stood at 4.6% at the end of April 2009, only a moderate increase from 3.9% at the end of August 2008. The rupiah-dollar exchange rates, the CDS spread, the share prices, and the official foreign exchange reserves, all of which have been exposed to a strong downward pressure amid the global financial crisis, have more or less returned to the levels before the "Lehman Shock". The damage caused by the global financial crisis was contained limited. Thus, it could be viewed that Indonesia, through the course of the stress imposed by the global financial crisis this time, proved its strengthened resilience to temporary external shocks.

5. Trend of current account balance and the increased volatility of non-residents' portfolio investments

5.1 Strengthened resilience to external shocks

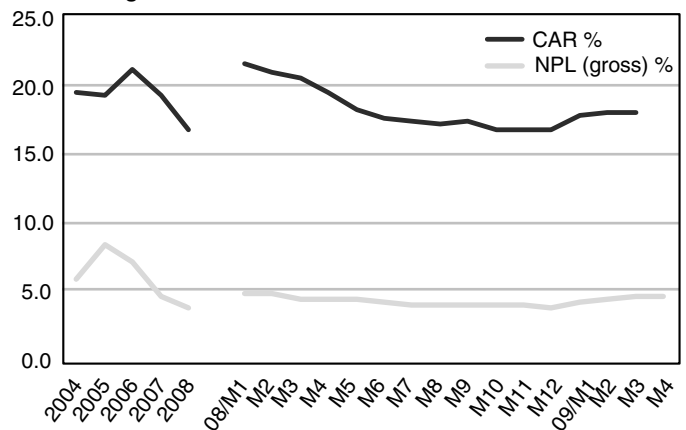
Indonesia's official foreign exchange reserves stood at US\$ 57.9 billion at the end of May 2009, equivalent to 5.5 months of its imports and official external debt payments in 2008 and 2.5 times as much as its short-term external debt (on a

14. The authorities' policy responses to crisis (Oct. - Nov. 2008)

10/13/2008	Increase in deposit guarantee ceiling (IDR 100 mn --> 2 bn)
10/14/2008	Reduction in foreign reserve requirements for commercial banks
10/16/2008	Introduction of a legal framework on Financial System Stability
10/28/2008	Announcement of 10 points economic packages (on the output and foreign currency liquidity)
10/30/2008	Formulation of FY2009 budget that includes various tax reduction measures
11/12/2008	Introduction of a regulation to mitigate foreign currency speculative purchases over 100,000 US\$ per month
11/19/2008	Establishment of BI's new liquidity facilities for banks
11/21/2008	Placement of PT Bank Century under public control

Sources: various news reports

15. Banking indicators



Source: Bank Indonesia

RATING PERSPECTIVE

16. Balance of payments

	2004	2005	2006	2007	2008	2008 Q1	Q2	Q3	Q4	2009 Q1
Current account	1,563	277	10,860	10,493	300	2,817	-956	-885	-677	1,793
Goods	20,152	17,533	29,660	32,754	22,909	7,536	5,443	5,771	4,159	6,226
Services	-8,811	-9,122	-9,884	-11,841	-12,741	-2,972	-3,291	-3,196	-3,282	-2,546
Income	-10,917	-12,927	-13,790	-15,525	-15,253	-3,119	-4,466	-4,796	-2,871	-3,030
Current transfer	1,139	4,793	4,863	5,104	5,385	1,373	1,359	1,336	1,317	1,144
Capital and financial account	1,852	345	3,025	3,591	-2,132	-1,430	2,512	904	-4,118	2,365
o/w Direct investment	1,896	8,336	4,914	6,928	7,919	1,460	2,040	1,921	2,498	3,511
o/w Portfolio investment	4,056	5,270	6,107	9,981	3,015	2,807	4,128	-9	-3,910	1,734
o/w External debt	-2,141	-1,122	-2,882	-1,161	2,822	-154	-501	1,509	1,967	489
Overall balance	309	444	14,510	12,7152	-1,945	1,032	1,324	-89	-4,212	3,955

Source: Bank Indonesia

maturity basis, as of the end of March 2009). Also, Indonesia is now eligible to raise up to US\$3.2 billion through the currency swap arrangements under ASEAN+3 Chiang Mai Initiative (CMI) without IMF program (US\$16 billion in total should there be an IMF program), following the recent increase in the size of the bilateral swap arrangement (BSA) between Indonesia and Japan in April 2009. Furthermore, in May 2009, Indonesia and Japan made a basic agreement to reach another BSA between Japanese yen and Indonesian rupiah totaling 1.5 trillion yen. Thus, Indonesia is getting more resilient to short term external shocks with these foreign currency liquidities.

5.2 Changing trend of the country's current account

Nevertheless, attention still has to be paid on a few areas. The first one is the trend of the current account. Indonesia has maintained current account surplus continually since 1998. Indonesia's trade balance has kept surplus (on both "non-oil and gas" and "oil and gas"), recording 6.8% of GDP on average between 2004 and 2008. This was more than enough to cover the deficit in services account during the same period. However, in the second to fourth quarters of 2008, the trade surplus decreased by 23 to 56% on year on year basis. As a result, the current account balance fell to a deficit. Although the current account returned to the surplus in the first quarter of 2009, the tendency is more likely to be deficit than surplus in the medium term, which itself is not always a concern especially when the economy grows steadily. However, deterioration in the terms of trade owing to the international price rises in raw materials and capital goods needs to be paid certain attention.

5.3 Volatile inflows and outflows of portfolio investments by non-residents

Secondly, the capital account, especially the inward portfolio investment, deserves attention. In recent years, lured by relatively high nominal interest rates, large amount of inward portfolio investment has flown into Indonesia, whose accumulated stock amounted to US\$71.8 billion (17% of GDP and 126% of official foreign exchange reserves) at the end of 2007. This inward portfolio investment showed high volatility in 2008. In the first and second quarters, it posted

net inflows of US\$2.8 and US\$4.1 billion, respectively, followed by a net outflow of US\$3.9 billion in the fourth quarter. With the easing of global financial crisis, it regained a net inflow of US\$1.7 billion in the first quarter of 2009. Nevertheless, as the central bank has cut down the policy interest rate substantially, there still remains a risk of large reversal of non-residents' portfolio investment if we saw the worldwide deterioration in the financial condition again. If those situations occurred and persisted, Indonesia's balance of payments and foreign exchange rates would face great pressures. Therefore, the inflows and outflows of inward portfolio investment have to be carefully watched.

6. JCR's rating views and perspectives

JCR, in July 2009, upgraded its ratings on the foreign currency long-term senior debts of the Republic of Indonesia to BB+ from BB and those on its local currency long-term senior debts to BBB- from BB+. The action reflects its view that, while the influence of the global financial crisis was limited and its economy maintains a positive growth albeit slower, its government debt burden has diminished significantly as well as the resilience against external shocks has been enhanced on the back of the government's prudent economic policies.

On the other hand, the rating outlook both on its foreign and local currency long-term senior debts remains "stable." It is based on its view that, though its political stability is increasing under a democratic political system and the government's continued prudent economic policies and thereby macroeconomic stability as well as sound fiscal conditions may well be maintained, the world economic outlook is still uncertain and the increasingly volatile inflows and outflows of portfolio investments in recent years may significantly affect the country's international balance of payments and foreign exchange rates.

For possible further upgrades of the ratings on Indonesia, it is crucial for the authorities to not only continue maintaining macroeconomic stability but also raise the growth potential and structurally reinforce the resilience against fiscal and external shocks by eliminating bottlenecks of economic activities such as developing infrastructure and improving the business environment.

JCR

17. Republic of Indonesia: Economic indicators

		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 (forecast)
Real GDP growth	(%)	4.9	3.6	4.5	4.8	5.0	5.7	5.5	6.3	6.1	3.5
Unemployment rate	(%)	6.1	8.1	9.1	9.5	9.9	11.2	10.3	9.1	8.4	9.5
CPI (period average)	(%)	3.8	11.5	11.9	6.8	6.1	10.4	13.3	6.4	9.8	4.7
Lending rate (working capital)	(%)	18.5	18.5	18.9	16.9	14.1	14.1	16.0	13.9	13.6	11.7
Budget deficit/GDP	(%)	-1.5	-2.5	-1.3	-1.7	-1.0	-0.5	-0.9	-1.3	-0.1	-2.6
Interest payment / Total revenue	(%)	24.4	29.0	30.7	20.3	15.5	15.2	12.4	11.2	9.0	11.2
Public debt/GDP	(%)	88.4	77.0	67.4	61.3	56.4	46.0	39.0	35.2	32.8	32.9
Export (Goods)	(US\$ bn)	65.4	57.4	59.2	64.1	70.8	87.0	103.5	118.0	139.6	113.4
Import (Goods)	(US\$ bn)	40.4	34.7	35.7	39.5	50.6	69.5	73.9	85.3	116.7	95.6
Current account/GDP	(%)	4.8	4.3	4.0	3.5	0.6	0.1	3.0	2.4	0.1	0.0
Foreign reserves	(US\$ bn)	29.4	24.9	32.0	36.3	36.3	34.7	42.6	56.9	51.6	57.2
do. (Months of imports)	(months)	8.5	8.3	10.5	10.6	8.3	5.7	6.7	7.7	5.1	7.2
Gross external debt/GDP	(%)	88.4	77.0	67.4	61.3	56.4	46.0	39.0	35.2	32.8	28.6
Net external debt/GDP	(%)	68.6	67.9	51.1	42.8	39.7	34.1	24.0	18.9	19.5	17.6
Foreign reserves/Short-term external debt	(times)	n.a.	n.a.	n.a.	6.7	4.5	3.0	3.4	2.9	2.1	2.4
Gross external debt/Export	(%)	216.6	232.0	222.0	211.2	193.6	150.2	124.3	115.8	106.8	131.8
Net external debt/Export	(%)	173.1	190.0	169.1	156.6	144.2	112.1	84.6	69.2	71.3	81.4
Debt services ratio	(%)	41.1	41.4	35.5	29.5	31.7	28.0	37.6	31.1	32.3	33.8
Exchange rate (period average)	(US\$1=)	8,422	10,261	9,311	8,577	8,939	9,705	9,159	9,141	9,699	10,250

Source: Bank Indonesia, BPS, CEIC, Indonesian MOF