

SURVEY OF RECENT DEVELOPMENTS

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SUMMARY

Apart from the peaceful December elections in Aceh, many major recent news stories from Indonesia have been about disasters of some kind: the sinking of an inter-island ferry, the crash of a commercial plane, the continuing misery caused by a seemingly unstoppable mud flow in East Java, and severe flooding in and around Jakarta. The largely symbolic dissolution of the Consultative Group on Indonesia in January has helped neutralise economic nationalist criticism of the president.

The rate of output growth rose to 6.1% in the December quarter, driven by a sudden surge in investment spending. Inflation was modest, at 6.3% in the year to January 2007; the exchange rate has been steady; and the Jakarta Stock Exchange has been booming. The budget deficit is well under control, and public debt continues to decline relative to GDP. At the same time, it is a concern that exchange rate and monetary policies have increasingly come to resemble those in the months preceding the 1997–98 crisis.

Recent surveys confirm that Indonesia's investment climate remains poorer than those of its neighbours. The problem is exemplified by the uncertainty facing new investment in the oil and mining sectors: oil exploration has been sluggish, causing output to fall well below Indonesia's OPEC quota and, although mining operations have been highly profitable in recent years, spending on exploration and new mine development has declined steadily. Meanwhile, the government's hopes of improving infrastructure through public-private partnerships were met with a wait-and-see attitude by private sector participants attending a second infrastructure summit in November.

Non-oil manufacturing grew more slowly than GDP in 2006, reversing the outcome for 2005. Non-oil manufactured exports grew steadily over 2004–06, but there seems little prospect of a resumption of the double-digit growth of the late 1980s and early 1990s. Aside from the poor investment climate and infrastructure shortcomings, the constraints on manufactured export growth include strong competition from China and Vietnam and declining competitiveness resulting from big increases in regulation-driven labour costs.

In March 2006 the poverty rate stood at 17.8%, up from 16.0% in February 2005. A World Bank study has attributed this to the large increase in rice prices caused by the ban on rice imports. It argues that the Unconditional Cash Transfer program, which provided direct cash transfers to 19.2 million poor and near-poor households, more than offset the impact of the steep fuel price increases in 2005, although these findings have been the subject of vigorous debate.