

SURVEY OF RECENT DEVELOPMENTS

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SUMMARY

Notwithstanding improvements in Indonesia's political and institutional infrastructure, growth remains slower than in pre-crisis years, and there is much discussion about reinvigorating the economy. To this end, the government introduced its fourth major policy package in June 2007, risking scepticism about its underlying resolve to implement reforms that conflict with the interests of influential bureaucrats. The abandonment of previous attempts at labour market reform was perhaps the most conspicuous element of the new package.

Economic growth continued to accelerate, reaching 6.3% in the second quarter. Most first-half growth was driven by net exports and investment, even though construction activity slowed noticeably in this period. On the production side, output of non-tradables continues to outstrip that of tradables. Consumer price inflation rose in the September quarter to the top of the central bank's target range, and seems likely to increase further. The stock market boom continued in the year to September, notwithstanding a brief correction in August. Bank Indonesia's exchange rate and monetary policies have created an arbitrage opportunity that appears to be contributing significantly to private capital inflow. The 2008 budget maintains a modest deficit, but contains seemingly unrealistic plans for large increases in certain categories of spending and in tax revenue. Moreover, the projected world oil price is so low as to call into question the transparency of fiscal policy.

There is concern that Indonesia's recent growth has depended too heavily on commodity prices, but real export growth was in fact substantial in the first half of 2007. Moreover, although Indonesia's share of non-fuel exports as a whole in the world market has been eroded somewhat in recent years, this masks large variations in shares across major markets and product categories. Its market share rose conspicuously for key primary products in some markets, while it has been losing market share in a number of labour-intensive manufactures, adding weight to concern about the impact of labour market policies on employment growth. Employment in fact grew strongly in the year to February 2007, pushing unemployment down a little, and contributing to a reduction in poverty incidence. However, employment growth has been conspicuously slow in manufacturing—particularly in labour-intensive industries. Meanwhile, newly announced closures of certain industries to particular kinds of investors have done little to improve the business environment.