

## **SURVEY OF RECENT DEVELOPMENTS**

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### **SUMMARY**

The second half of 2008 is proving to be a time of unprecedented global volatility, and the sound performance of the Indonesian economy over the first half will be difficult to maintain. With growth for the year projected to remain around 6%, Indonesia is relatively well placed to face the challenges of the unfolding global financial crisis, but the risks to the outlook are increasing. The crisis has begun to impact directly, with trading on the Indonesian stock market suspended on 8 October after an alarming one-day fall of 10% in share prices. Sustained pressure on the currency since mid-August has also seen Bank Indonesia running down its sizable foreign exchange reserves in attempting to support the rupiah. The authorities are taking steps to relieve liquidity pressures in the financial system, but will also need to address medium-term issues of stability, especially in relation to inflation; interest rate increases have so far done little to contain prices. Although exports have remained surprisingly strong, rapid import growth has resulted in a small current account deficit. Growth of exports is likely to decelerate as demand in developed economies slows, putting further pressure on the balance of payments and the currency.

The 2009 budget reflects the government's positive outlook, but the underlying assumptions about growth, inflation and interest rates seem rather optimistic. Tax revenue has been increasing strongly, allowing the government to allocate significant new spending to education, in particular; however the budget remains hostage to global oil prices, with energy subsidies still very large despite the unpopular recent increases in domestic fuel prices. Other issues likely to affect voting in the 2009 elections include scheduled electricity blackouts in Jakarta in response to demand continuing to outstrip supply; the government's apparent indifference to the fate of the victims of the Sidoarjo mud disaster; and its failure to make much impact on the level of poverty.

Despite asking major donors for additional loans for budget support, the government has unveiled a new strategy for managing development partnerships. This will encourage smaller donors to operate through multi-donor arrangements and larger donors to use government systems for more of their programs—a signal that the government intends to shape its relationships with donors despite the global crisis.

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