

April 2008

OVERVIEW

- **Aceh's non-oil and gas economy grew by 7.4 percent in 2007.** This was slightly above the national growth rate of 6.9 percent. Reconstruction continued to drive economic growth, although other sectors that are not dependent on oil and gas, such as agriculture and manufacturing, also grew.
- **Although they still account for more than one quarter of Aceh's economy, oil and gas, and related manufacturing sectors continued to contract despite high international prices.** As a result, Aceh's overall economy including the oil and gas sector declined by 2.2 percent, largely due to the rapid depletion of oil and gas reserves.
- **Agriculture grew by 4.9 percent, double the growth rate of agriculture in Sumatra as a whole.** This expansion was led by estate crops and fisheries, partly reflecting the improved security situation and results of the reconstruction effort.
- **The disparity between regional and the national inflation rates is narrowing, but inflation in Aceh is still almost twice the national level.** Inflation of 11 percent in 2007 was fuelled by unmet demand in local markets and rising international prices. Despite this, Aceh's 2007 inflation rate compares favorably with average inflation levels of almost 25 percent in both 2005 and 2006.

Data Note:

This note, as the first Aceh Economic Update in April 2007, uses data collected from official Indonesian sources, primarily BPS and Bank Indonesia. Some data have undergone significant revisions, such as GDP data for 2006 and the banking sector data. Since the last update, the following new data sources have become available and are reflected in this update: Preliminary GDP 2007, trade, banking and inflation data in 2007. In analyzing these data, Bank Indonesia, together with the World Bank, has endeavored to improve understanding of the impact of the tsunami and the reconstruction effort on Aceh's economy.

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I. Gross Domestic Product

If oil and gas are excluded, Aceh's economy continued to grow, reaching Rp 73 trillion by end 2007. The reconstruction effort continued to drive economic growth, with sectors linked to the reconstruction effort, such as construction, utilities and transport, showing above average growth rates. Conversely, if oil and gas production is included, then the economy contracted by over 2 percent. This was the result of rapidly depleting oil and gas reserves and the decline of manufacturing and industry linked to oil and gas production. This contraction in a key sector in Aceh's economy is projected to continue as known oil and gas reserves along Aceh's east coast are exhausted.

Growth in reconstruction-related activities continued, but showed signs of slowing.

Growth in construction in 2007 was down to 14 percent, from almost 50 percent in 2006. Similarly, growth slowed in other services sectors such as transport, trade and hospitality. This is supported by data on hotel occupancy rates from the Tourism Office in Aceh, which recorded a decline in guests from 11,408 in 2006 to 9,735 in 2007. Reconstruction progress as of December 2007 showed that over 100,000 houses and 2,000 km of roads had been built.¹ Significant reconstruction activity is expected to continue in 2008, with only 61 percent of allocated funds spent by December 2007. However, the gradual exit of some NGOs, donors and, most importantly, the BRR by early 2009 means that reconstruction will be less of an engine for growth from 2009 onwards.

¹ www.e-aceh-nias.org

Economic growth, 2003-07 (%)					
Sector	2003	2004	2005*	2006**	2007**
Agriculture, Forestry & Fishery	3.2	6.0	-3.9	1.5	4.9
Mining and quarrying	9.8	-24	-22.6	-2.6	-21.6
Oil & Gas	9.9	-24.4	-23.0	-4.3	-22.6
Quarrying	3.6	7.3	0.8	78.8	2.0
Manufacturing Industry	1.6	-17.8	-22.3	-13.2	-10
Oil and gas Industry	1.7	-11.6	-26.2	-17.3	-16.7
Non-oil and gas industry	1.6	-37.3	-5.1	1.1	8.6
Electricity, Gas & Water Supply	16.9	19.5	-2.0	12	23.7
Construction	0.9	0.9	-16.1	48.4	13.9
Trade, Hotels and Restaurants	2.4	-2.6	6.6	7.4	1.7
Transport & Communication	3.8	3.6	14.4	10.9	11
Banking & financial services	30.9	19.4	-9.5	11.7	6
Services	6.3	20.1	9.7	4.4	14.3
GDP	5.5	-9.6	-10.1	1.6	-2.2
GDP w/o oil & gas	3.7	1.8	1.2	7.7	7.4

* = revised figures

**= preliminary figures

Source: BPS

Agriculture is recovering, expanding by almost 5 percent in 2007.

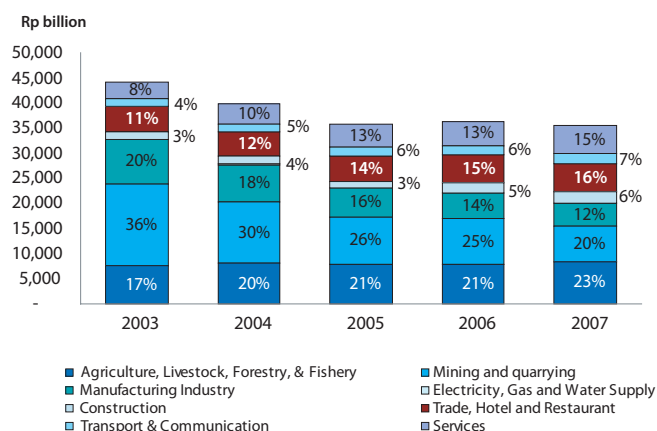
This means that the sector has now surpassed pre-tsunami agricultural production for the first time. This growth rate compares with average agricultural growth of only 2.3 percent in Sumatra as a whole. Growth has been led by estate crops, up by over 15 percent since the tsunami, followed by food crops and the fisheries sector. Growth in agriculture can be traced back to improved security conditions, as well as the results of the reconstruction effort, which by December 2007 had allocated about US\$300 million to the agriculture and fisheries sectors. Growth in manufacturing (not related to oil and gas) also increased significantly in 2007, up 8 percent on 2006 led by the food and beverage, and wood and paper industries.

Agricultural production (Rp Billion)					
	2003	2004	2005	2006	2007
Farm food crops	3,022.0	3,253.4	3,144.8	3,179.1	3,449.3
Non-food crops	1,188.2	1,453.9	1,529.9	1,533.8	1,674.0
Livestock & products	1,428.4	1,414.0	1,296.3	1,325.9	1,206.1
Forestry	823.2	621.3	531.3	547.2	567.9
Fishery	1,147.4	1,326.4	1,252.7	1,286.8	1,365.3

Source: BPS, Constant 2000 prices.

Aceh's economic structure is changing rapidly, driven partly by the reconstruction effort. There is a clear trend away from mining and manufacturing. These two sectors accounted for 56 percent of the economy in 2003, but this had fallen to only 32 percent by 2007. This decline was somewhat balanced by growth in the services sectors (e.g. trade, construction and transport), which together accounted for 44 percent of Aceh's economy in 2007, up from 26 percent in 2003 and growth in the agricultural sector, which expanded from 17 percent in 2003 to 23 percent in 2007.

Aceh's Economic Structure, 2003-07

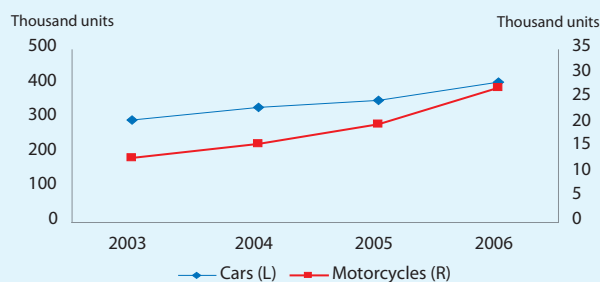


Source : BPS, Constant 2000 prices.

Vehicle Purchases in Aceh

Growth in the past few years is also reflected in the purchase of cars by the Acehnese. Data from the Provincial Revenue Office show a significant increase in the number of vehicle registrations. Car registrations increased by over 60 percent, while the largest increase was recorded in motorcycles, which increased by over 70 percent.

Number of Vehicles



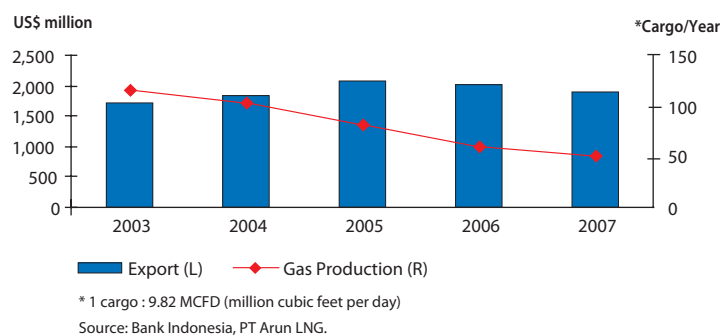
Source : Provincial Revenue Office

II. Trade²

Aceh's exports continued to decline as gas production contracted. Exports declined by 6 percent in 2007 to US\$1.8 billion. However, non-oil and gas exports increased significantly to US\$84.3

million in 2007. This increase was led by fertilizer, which accounted for almost 80 percent of non-oil and gas exports, despite both production and exports of fertilizer all but disappearing in 2006. Production of both fertilizer and paper has resumed in locations close to the gas fields, after the government made a commitment to continue subsidizing gas for these two industries until 2010.

Aceh's Exports, 2003-07

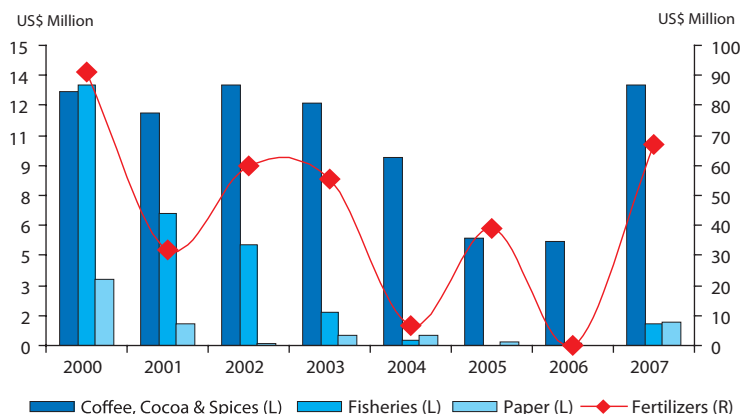


* 1 cargo : 9.82 MCFD (million cubic feet per day)

Source: Bank Indonesia, PT Arun LNG.

Agricultural exports continued to grow in the second half of the year reaching US\$14 million in 2007. Growth in agricultural exports was led by coffee and fisheries. The increase in exports of these commodities may have been partly the result of the end of armed conflict, while reconstruction assistance has probably also contributed, together with increasing international prices.³ Fisheries exports, about US\$1 million in 2007, increased significantly since the tsunami, but remain well below their peak of US\$13 million in 2000. Imports declined in 2007, due to a relatively large reduction in the import of inputs and machinery for the extraction and refinery of gas. However, imports of food increased for a third consecutive year. As for imports, a large share of imports passed through Medan. This is illustrated by significant increases in the value of imported building materials into Medan. For example, imports of steel for housing increased by 23 percent in 2006 and almost 18 percent in 2007 (BPS, Medan).

Aceh's Main Non-Oil and Gas Exports (2000-07)



Source : Bank Indonesia

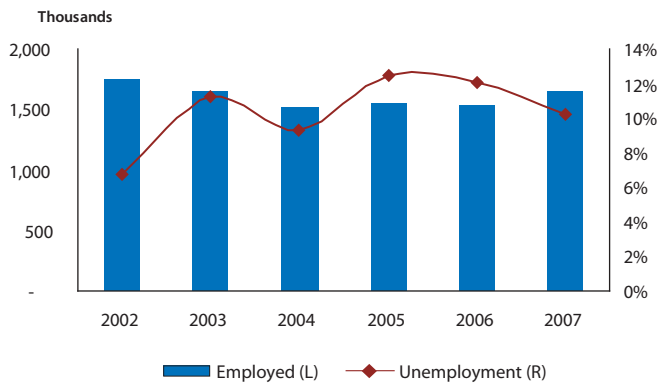
² Trade data used in this brief only capture trade going through Aceh. A large percentage of Aceh's trade passes through Medan and is then transported by road to Aceh. Therefore, these data are likely to underestimate trade in Aceh, particularly exports of non-fuel commodities such as coffee and palm oil, and imports related to the reconstruction effort.

³ According to the Aceh Partnership Economic Development (APED) project by UNDP and the Government of Aceh, in 2007, total Arabica coffee production in the highlands increased by 15 percent to 38,102 ton, whilst cacao production increased by 8% to 15,732 ton in 2007. The export price of Indonesia's Arabica coffee has increased from US cents 80/lb in 2004 to US cents 124/lb in 2007, www.ico.org.

III. Employment

Unemployment remains high despite the employment opportunities created by the reconstruction effort. After three years of reconstruction in Aceh, and as the reconstruction effort starts to slow, employment remains a challenge. The unemployment rate increased significantly in 2003 as the security situation worsened, and has remained at relatively high levels since then.⁴ A lack of labor mobility and a relatively unskilled workforce mean that many unemployed Acehnese have failed to benefit from the employment opportunities created by the reconstruction effort. As a result, the reconstruction effort has only absorbed a limited number of Acehnese workers, and many skilled and semi-skilled workers have come to Aceh from neighboring North Sumatra and other regions of Indonesia.⁵

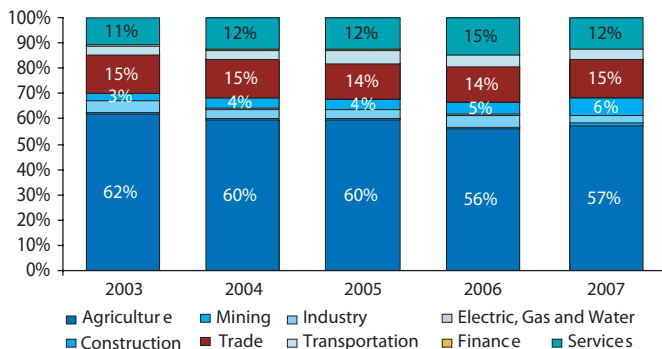
Aceh's Employment, 2002-07



Source: BPS

Agriculture continues to be the largest employer in Aceh, absorbing almost 60 percent of the workforce. Nevertheless, the sector has been shedding labor since before the tsunami and is likely to continue doing so as productivity increases and more people find employment in other sectors, as has happened in the rest of Indonesia.

Sectoral Employment Composition (%)

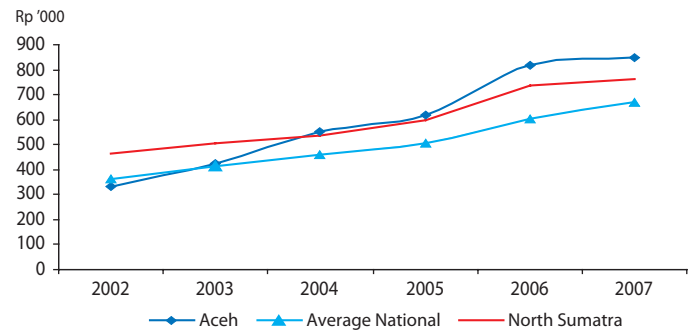


Source: BPS

Wages continued to increase in Aceh, compromising the

province's competitiveness. Aceh's minimum provincial wage (UMP) is the second highest in Indonesia. The UMP increased by 37 percent since 2004 to Rp 850,000 in 2007. However, given that price levels have almost doubled since the tsunami (as measured by BPS in Banda Aceh), the increase in the UMP is not enough to maintain purchasing power of those receiving it. The apparent contradiction between high unemployment levels and rising wages could be the result of unmet demand for certain types of skills by the reconstruction effort, as well as the concentration of assistance in certain regions in Aceh and a lack of labor mobility.

Minimum Provincial Wages in Comparison



Source: Manpower Office, Aceh.

Poverty Dynamics in Aceh

Poverty increased in Aceh from 28.4 percent of the population in 2004 to 32.6 percent in 2005, a relatively low increase in poverty given the scale of the disaster and destruction it caused. By 2006, poverty had declined to 26.5 percent, below pre-tsunami levels, a result of the end of conflict and the large reconstruction effort. Poverty levels in 2007, as estimated by BPS, were similar to those in 2006. Families in tsunami- and conflict-affected areas were more likely to be poor than families in areas not affected by the tsunami or conflict in 2005. This disparity had disappeared by 2006, suggesting a relatively short-lived rise in tsunami-related poverty. Poverty in Aceh, as in other parts of Indonesia, is predominantly a rural phenomenon, with over 30 percent of the people in rural areas living below the poverty line, compared with less than 15 percent in urban areas.

Aceh's poverty rate, 2004-07 (%)

	2004	2005	2006	2007*
Aceh	28.4	32.6	26.5	26.7
Aceh – Urban	17.6	20.4	14.7	18.7
Aceh – Rural	32.6	36.2	30.1	29.9
Indonesia	16.7	16.0	17.8	16.6

* 2004-2006 poverty levels for Aceh from World Bank, 2008, 'Aceh Poverty Assessment'; 2007 data are from BPS and therefore not directly comparable.

⁴ An apparent reduction in unemployment in 2007 is primarily the result of the timing of the labor survey (see previous Aceh Economic Update for further elaboration on this point).

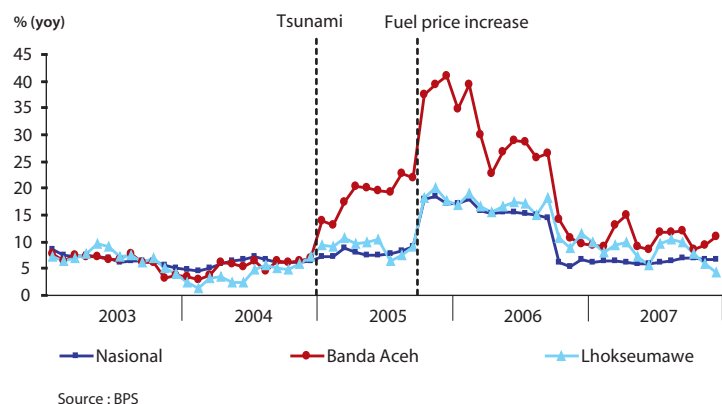
⁵ UNDP estimated that the reconstruction effort would need approximately 120,000 workers. About 1/3 of this additional demand would be supplied by the local labor market, while the rest would have to come from other parts of Indonesia (UNDP, 2006, 'Construction Boom').

IV. Inflation

Inflation in Banda Aceh remains high, although the gap with the national level has narrowed. Inflation remains high in Aceh

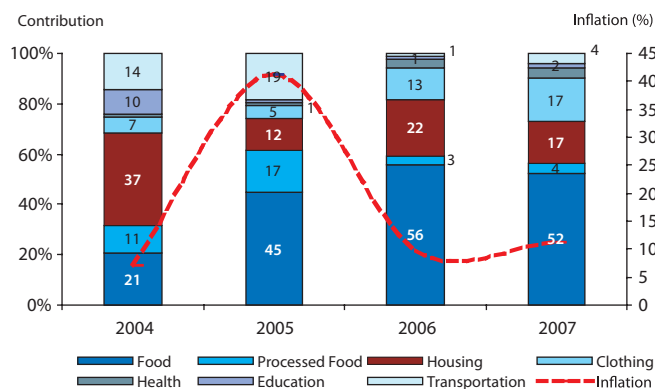
(as measured in Banda Aceh) as a result of prolonged high demand for goods and services to supply the reconstruction effort, combined with little supply response in terms of increased production. The festive season and the global increase in commodity prices contributed to higher year-end inflation, although both these effects are common to the country as a whole and fail to explain the differential in inflation levels. Prices of many commodities, including fuel, are projected to remain high in international markets, which is likely to translate into renewed inflationary pressures in 2008.

Inflation, 2003-07



Since the tsunami, food has been the main contributor to inflation in Aceh. Other key contributors to inflation in Aceh have been housing and clothing. Among food items, rice and fish have seen the largest price rises.

Inflation's Contributors, 2004-07



V. Banking Sector

The banking sector continued to show a healthy performance, although assets and deposits declined slightly in 2007. After enjoying a significant increase in assets and deposits, probably result of a temporary influx of funds for reconstruction, this slowed in 2007, with assets and deposits declining by 15 and 16 percent, respectively. Profits continued to increase, growing by 32 percent in 2007. The banking sector also increased the supply of credit, and the loan-to-deposit rate increased significantly to pre-tsunami levels. This might be a reflection of the larger number of banks operating

in Aceh. Since the tsunami, three private banks, one syariah bank and six rural banks (BPR) have entered Aceh, bringing the total to 13 private banks, five syariah banks and 21 rural banks.

Assets and liabilities in Aceh's banking sector, 2003-07

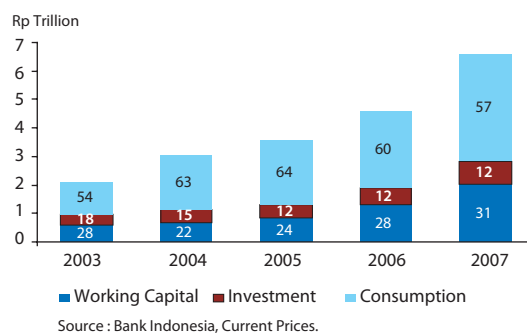
Indicator	2003*	2004	2005	2006	2007
Asset (Rp Bn)	9,826.7	10,461.8	16,463.2	27,403.9	23,301.5
3rd Party Funds (Rp Bn)	7,367.3	7,704.9	13,850.5	21,928.1	18,304.9
Credit (Rp Bn)	2,094.0	2,971.9	3,599.2	4,598.0	6,573.9
Profit / Loss (Rp Bn)	68.6	55.6	-6.3	371.0	490.8
NPL Aceh (%)	2.5	2.8	2.9	1.2	1.3
NPL National (%)	8.2	5.8	8.3	7.0	4.6
LDR Aceh (%)	28.4	39.5	26.0	21.0	35.9
LDR National (%)	53.7	61.8	64.7	64.7	69.2

* Revised figures

Source: Bank Indonesia, Current Prices.

Credit allocation grew by over 40 percent in 2007, by far the largest increase since the tsunami.⁶ But, as in previous years, over half of the total credit went towards consumption. There was a slight increase in the allocation of credit for working capital, reflecting a recovery in economic activities in some sectors.

Credit Allocation



Economic Outlook 2008

- **Reconstruction will continue to drive growth in Aceh in 2008.** Although the reconstruction effort has already provided large numbers of houses and infrastructure significant gaps remain. Consequently, many organizations will continue to operate in Aceh in 2008, ensuring that sectors related to the reconstruction effort continue to drive growth, although probably at a somewhat slower pace than previously.
- **Unemployment remains the main challenge in economic policy-making.** There is scant evidence of private investment in the primary or secondary sectors of the economy. With a gradual exit of reconstruction players during 2008 and early 2009, there will be upward pressure on the unemployment rate.

⁶ The data presented in this section are not comparable to credit allocation data in previous Aceh Economic Updates. While previous data considered credit allocation in Aceh, regardless of the location of the bank providing the credit, these data reflect only the credit provided by banks located in Aceh.