

STATEMENT BY GOVERNOR OF BANK INDONESIA
MR. BURHANUDDIN ABDULLAH
AT THE 14TH MEETING OF THE CONSULTATIVE GROUP ON INDONESIA
JAKARTA, 19-20 JANUARY 2005

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*Chairman of the CGI,
Distinguished Delegates
Ladies and Gentlemen,*

It is both a pleasure and an honor for me to be addressing the Consultative Group on Indonesia. This group of donor countries has been supporting the Republic for so many years, [first as IGGI and then as CGI] that I feel as if I were speaking to friends. The CGI has been with us through bad times and through good times, through rainy days and through happy days and this year is certainly the most terrible year the Republic has lived through with the tsunami catastrophe in Aceh and North Sumatra. We therefore, value your presence here in Jakarta with a sense of appreciation.

Ladies and Gentlemen,

Now, allow me to briefly touch some issues that are of the core of Bank Indonesia's functions, which are monetary and banking policies.

The year 2004 was a year full of accomplishments but also a year full of challenges. Perhaps we can say that 2004 was a year where we experienced the peak of political transition and in the process we have successfully conducted the general election in a democratic, peaceful, honest, and fair manner. Against this background, by maintaining sound monetary policy supported by free capital flows and a floating foreign exchange regime, the Central Bank illustrated the continuity of the economic policy and successfully achieved:

- The stabilization of the currency at around 8.900 Rp/US\$ (taking into account a slight depreciation of 3.7% over the year),
- The lowering of domestic interest rates until mid 2004 and
- Inflation and inflation expectations were kept low. Year-on-year inflation reached 6.4% at the end of 2004.

In a wider range, the macroeconomic situation of the country improved in 2004:

- Macroeconomic stability was achieved,

- Economic growth rate increased to 4.8%-5%, exceeding the yearly target
- International reserves went up to an all times high of US\$ 37.4 billion,
- External indebtedness declined, debt to GDP ratios improved
- The net export performance generated a surplus in the current account balance of the Balance of Payments. Exports and investment started to show signs of vitality enabling a broader base growth to take place.

Such improvements in the macroeconomic performance of the country was acknowledged by the capital markets in March 2004 with a successful bond issue and by international rating agencies which improved the credit rating of the Republic gradually over the year. The Republic is currently rated B2 by Moody's, B+ by both Standard and Poor's and FitchRatings.

Ladies and Gentlemen:

The momentum thus far have also generated a positive impact on the banking sector. This can be seen from the strengthening in the capital structure of banks and from the reduction of credit risks as well as increase in profitability. In fact, the banking industry enjoys one of the highest returns to capital.

To further enhance financial sector stability, a financial safety net framework has been established and will be promptly enacted in the law. As part of this framework, a new Deposit Insurance Law has been passed and the institution is now being established. Furthermore, combating money laundering has been one of our top priorities. The government, Bank Indonesia and Indonesian Financial Transactions and Analysis Centre (INTRAC/PPATK) have rigorously undertaken initiatives and exercised regulatory measures to exit from the Non Cooperative Countries/Territories list of the Financial Action Task Force (FATF).

Ladies and Gentlemen,

As we enter 2005, we look forward to continued improvement in the Indonesian economy. I am optimistic that macroeconomic stability will be sustained throughout the years to come. The rupiah is forecasted to hold stable with an appreciating trend, while inflation is predicted to stay on track with the government-mandated inflation target of 6%±1%. All of which should provide a supportive environment for investment and a higher sustainable growth of 5-6%. In this regard, the government commitment to promoting infrastructure is a key factor sustaining our optimism for improvement in sources of economic growth and especially investment.

From the external side, the optimism is supported by favorable global economic growth and high commodity prices. The improvement in export and increase foreign investor confidence will hopefully help to ease the pressure on balance of payments. The current account surplus is expected to decline due to higher expected imports. Nonetheless, our foreign exchange reserve is still expected to improve and reach USD. 36.5 billion by end of 2005.

On the banking sector, considering that higher economic growth would require a strong and efficient banking industry, our policy in 2005 will be focused on the effort to strengthen the banking industry by maintaining prudent bank supervision to ensure the soundness and effectiveness of the banking system. In this respect, Bank Indonesia's policies will be aimed to achieve the following five objectives. First, to accelerate the consolidation process in the banking industry. Second, to further adjust the mechanism and procedure of the banking system to be more supportive at the needs of the national economy. Third, to take steps to strengthen the financial system infrastructure. Fourth, to improve bank prudential aspects and intermediary functions. In this respect efforts will be focused upon developing a more prudent management of the banking industry and a stronger awareness of the risks attached to banks management. And as the fifth objective, we wish to position our national banking industry on a level comparable to those in our region by implementing the Basel II working framework in 2008.

Ladies and Gentlemen:

In conclusion, let me assure you that the Central Bank remains committed to pursuing a sound monetary policy in line with its mission to ensure the stability of the currency and prudent bank supervision to ensure the soundness and effectiveness of the banking system. Free capital flows and a floating foreign exchange regime will remain the underlying fundamental principles of our monetary policy.

Thank You

**GOVERNOR
BANK INDONESIA**

Burhanuddin Abdullah