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## 1.0 INDONESIA: CONSUMER DRIVEN GROWTH, MODERNIZING EXPECTATIONS

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### EXECUTIVE HIGHLIGHTS

- The Indonesian archipelago is the world's largest island complex. It stretches from mainland Southeast Asia eastward between Australia and the Philippines and is bordered by three major bodies of water: the Indian and the Pacific Oceans and the South China Sea. It stretches 3,400 miles from east to west, further than the continental United States (2,900 miles) and the distance between Dublin and Moscow (1,750 miles).
- There are over 300 different ethnic groups in Indonesia each with their own cultural identity, speaking more than 250 distinct languages. The largest single ethnic group, the Javanese, accounts for 45% of the country's 240 million population.
- Religious beliefs are varied and nearly all the major world religions are represented, although about 86% of Indonesia's citizens profess Islam making it the country with the largest number of Muslims in the world. The government, however, is secular and notwithstanding the occasional conflicts, its religions and the cultures tend to be tolerant and accommodating. Valuing diversity is enshrined in the constitution under the philosophy of Pancasila and in the country's motto: Unity in Diversity.
- With a population of 240 million, Indonesia is the fourth most populous country in the world after China, India and the United States. It is the world's third largest democracy. Its capital city, Jakarta, is the 15th most populous urban agglomeration (15.1 million) and the 8th most populous city in the world (9.1 million).

- Politically, Indonesia is in the eleventh year of very successful transition from a highly centralized, rigid authoritarian regime to a decentralized democracy under which substantial fiscal and program responsibility has been transferred from the central government to regional administrations. The impact of the 1998 ASEAN economic collapse has been reversed with the positive outcome of strengthened financial regulatory processes which positioned Indonesia well during the 2008 Global meltdown. In recognition of its impressive political and economic evolution, Indonesia has been invited to join the G-20.

CASTLE ASIA  
CONFIDENTIAL

## 1.1 INTRODUCTION

The Indonesian archipelago is the world's largest island complex. It stretches from mainland Southeast Asia eastward between Australia and the Philippines and borders three major bodies of water, the Indian and the Pacific Oceans and the South China Sea. It stretches 3,400 miles from east to west, further than the continental United States.

With a population of 240 million (Table 1.1), Indonesia is the fourth most populous country in the world after China, India and the United States. It is the world's third largest democracy.

**Table 1.1**  
**WORLD'S MOST POPULOUS COUNTRIES 2009**

<b>RANK</b>	<b>COUNTRY</b>	<b>POPULATION (million) Est.</b>
1	China	1,338.6
2	India	1,166.1
3	European Union	491.6
4	United States	307.2
<b>5</b>	<b>Indonesia</b>	<b>240.3</b>
6	Brazil	198.7
7	Pakistan	176.2
8	Bangladesh	156.1
9	Nigeria	149.2
10	Russia	140.0
11	Japan	127.1
12	Mexico	111.2
13	Philippines	98.0
14	Vietnam	87.0
20	Iran	66.4
21	Thailand	65.9
27	Myanmar	48.1
47	Malaysia	25.7

Source: U.S. Census Bureau, International Database

Jakarta, its capital city, is the 15<sup>th</sup> most populous urban agglomeration and the 8<sup>th</sup> most populous city in the world (Tables 1.2 and 1.3).

**Table 1.2**  
**WORLD'S TWENTY MOST POPULOUS URBAN**  
**AGGLOMERATIONS<sup>1)</sup>, 2008**

RANK	CITY	COUNTRY (000)	POPULATION
1	Tokyo	Japan	33,800
2	Seoul	South Korea	23,900
3	Mexico City	Mexico	22,900
4	Delhi	India	22,400
5	Mumbai	India	22,300
6	New York	U.S.A	21,900
7	Sao Paulo	Brazil	21,000
8	Manila	Philippines	19,200
9	Los Angeles	U.S.A	18,000
10	Shanghai	China	17,900
11	Osaka	Japan	16,700
12	Calcutta	India	16,000
13	Karachi	Pakistan	15,700
14	Canton	China	15,300
<b>15</b>	<b>Jakarta</b>	<b>Indonesia</b>	<b>15,100</b>
16	Cairo	Egypt	14,800
17	Buenos Aires	Argentina	13,800
18	Moscow	Russia	13,500
19	Beijing	China	13,200
20	Dacca	Bangladesh	13,100

Source: GeoHive Q3 2009.

[Http://www.geohive.com/charts/city\\_notagg.php](http://www.geohive.com/charts/city_notagg.php)

<sup>1)</sup> The definition of agglomerations varies significantly from city to city, hence the difficulty of compiling an accurate, comparative list of the world's most populous urban areas

**Table 1.3**  
**WORLD'S TWENTY MOST POPULOUS CITIES**

RANK	CITY	COUNTRY (000)	POP	YEAR
1	Mumbai (Bombay)	India	11,914	2001
2	Sao Paulo	Brazil	11,017	2006
3	Shanghai	China	10,929	2006
4	Moscow	Russia	10,126	2006
5	Seoul	South Korea	9,820	2005
6	Delhi	India	9,817	2001
7	Karachi	Pakistan	9,339	1998
<b>8</b>	<b>Jakarta</b>	<b>Indonesia</b>	<b>9,146</b>	<b>2008</b>
9	Istanbul	Turkey	8,832	2000
10	Beijing	China	8,689	2001
11	Mexico City	Mexico	8,591	2000
12	Tokyo	Japan	8,483	2005
13	Shenzen	China	8,278	2005
14	New York City	U.S.A.	8,143	2005
15	Tehran	Iran	7,796	2004
16	Cairo	Egypt	7,787	2006
17	London	U.K.	7,429	2004
18	Bogota	Colombia	7,050	2007
19	Lima	Peru	6,955	2005
20	Dhaka	Bangladesh	6,480	2006

Source: GeoHive Q3 2009.

[Http://www.geohive.com/charts/city\\_notagg.php](http://www.geohive.com/charts/city_notagg.php)

Indonesia is the largest member of the ten-member Association of Southeast Asian Nations (ASEAN), in population and GDP. It has a literacy rate of 92%, a median age of 28, and a life expectancy of 71 years (Table 1.4).

**Table 1.4**  
**ASEAN DEMOGRAPHIC DATA - 2008**

	POP (MN)	NOM GDP (US\$ BN)	NOM GDP PER CAP (US\$)	MEDIAN AGE YRS	YR LIFE EXPECT- ANCY	LITERACY RATE (%)	UNEM- PLOYMENT (%)
<b>INDONESIA</b>	<b>240.3*</b>	<b>508</b>	<b>2,113</b>	<b>27.6</b>	<b>71</b>	<b>91.9</b>	<b>8.4</b>
PHILIPPINES	96.1	169	1,755	22.5	71	84.1	7.4
VIETNAM	86.1	91	1,035	27.4	72	90.0	4.7
THAILAND	65.5	273	4,174	33.3	73	94.0	1.4
MYANMAR	47.8	22	462	28.2	63	90.0	10.2
MALAYSIA	25.3	222	8,792	24.9	73	92.0	3.7
SINGAPORE	4.7	175	37,597	39.0	82	92.5	2.8

Source: IMF World Economic Database;  
CBS; CastleAsia; CIA Factbook. \* est. 2009

There are over 300 different ethnic groups in Indonesia each with their own cultural identity, speaking more than 250 distinct languages. The largest single ethnic group, the Javanese, accounts for 45% of the country's 240 million population. Religious beliefs are also varied and nearly all the major world religions are represented, although about 86% of Indonesia's citizens profess Islam making it the largest Islamic country in the world.

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## 1.2 GOVERNMENT AND ECONOMY

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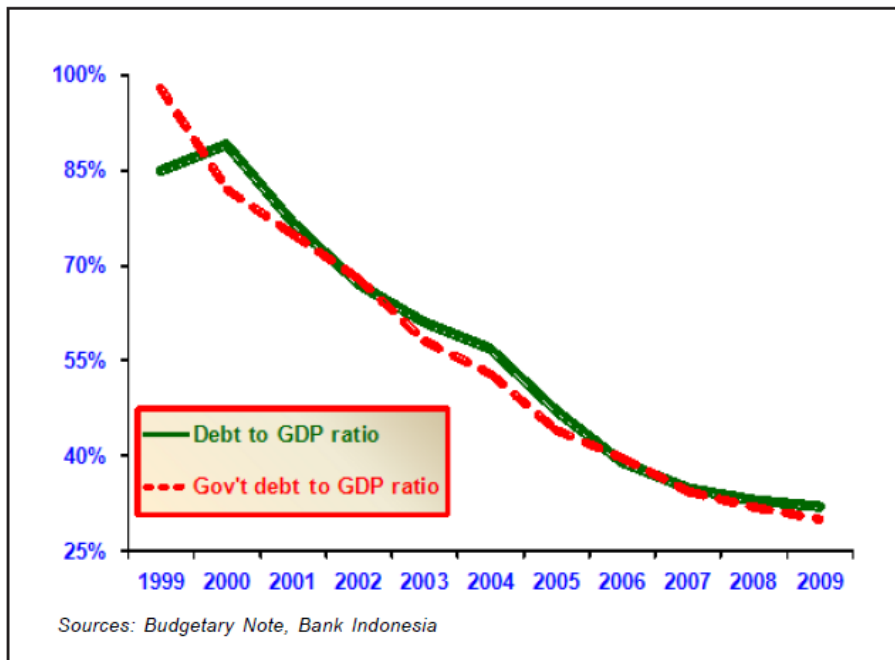
Indonesia is a complex social and political amalgamation with uneven access to resources and distribution of wealth. Politically it is in the eleventh year of a transition from a highly centralized, rigid authoritarian regime to a decentralizing democracy.

During the 25 years preceding the Asian economic crisis of 1997-98, Indonesia was one of the fastest growing economies in the world with average annual GDP growth of about 7%. During this period it moved from one of the world's poorest countries to middle income status as defined by the World Bank. The country suffered greatly in the 1997-98 Asian Economic Crisis as its economy collapsed and GDP contracted 14%, triggered in large part by bank failures and fraud. In the subsequent decade, Indonesia has more than recovered the losses while strengthening the financial sector regulatory environment. It joined the G-20 in 2008 and is now one of its fastest growing economies behind only China and India.

Since the authoritarian ruler Suharto relinquished control in 1998, three nationwide elections have been held, following the principle of one person, one vote and observed by international monitors. All these exercises of democratic process were virtually free of fraud, violence and intimidation, and supported by strong voter turnout. Today Indonesia is the third largest democracy in the world following India and the US.

The economy has recovered and performed quite well in the decade since the Asian crisis of 1997-98. Government debt ballooned during the crisis as banks were closed and toxic assets centralized under administrative control. In the period since then, Indonesia has managed its government debt burden well. The broadest measure of the impact of debt is the ratio of total government debt to total economic output or GDP. The ratio of public debt to GDP has fallen from 100 percent in 1999 to just over 30 percent in today (Figure 1.1). This is a level that compares favorably with neighboring countries which were less impacted by the Asian Crisis, and significantly better than most advanced countries today in the wake of 2008 sub-prime crisis.

Figure 1.1  
EASING DEBT BURDEN  
(Government Debt to GDP Ratio, Percent)



A further debilitating effect of the Crisis was the crash of the currency from its artificially managed level during the Suharto era. After reaching a low of 17,000 in 1998, the currency now fluctuates within a range from Rupiah 9,000 to 12,000 per US\$, and is now trading at the stronger end of this range.

**Figure 1.2**  
**RUPIAH VS US\$ (2004 to present)**



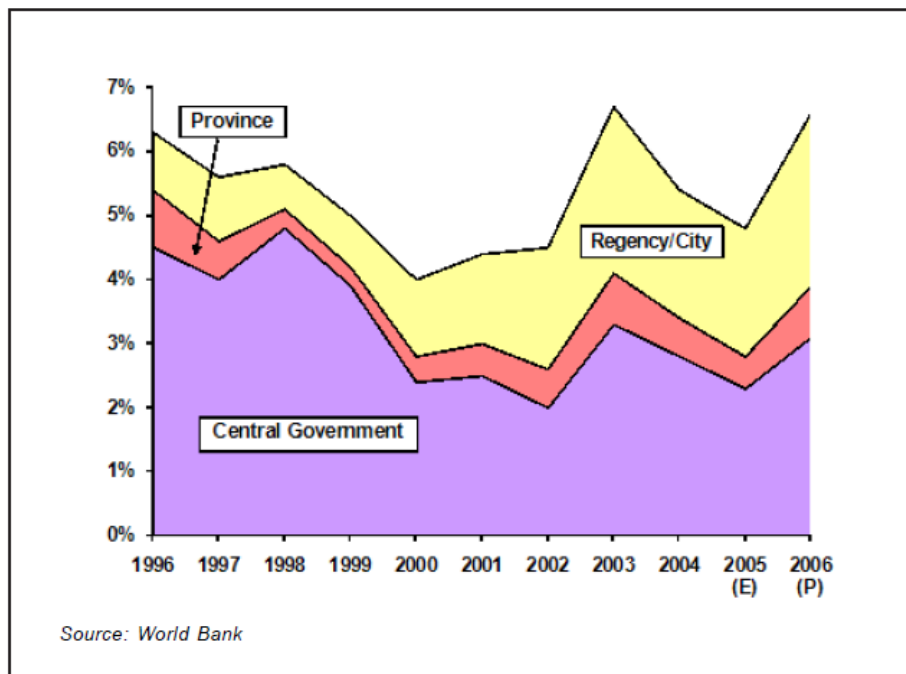
While current growth rates in excess of 5% are encouraging, the country needs economic growth rates of 6 to 7% to make significant inroads in raising per capita incomes, reducing unemployment and improving the quality of life for the majority of its citizens. The World Bank (2007) found that 7.4% of Indonesians consumed less than PPP US\$1 a day of goods and services and 49% consumed less than US\$2 a day, the two generally accepted benchmarks for the determination of poverty.

Compared with neighboring countries, Indonesia's US\$1 PPP poverty rate is similar to China (8.0%), the Philippines (9.6%) and Vietnam (6.2%). These three countries have, however, US\$2 PPP poverty rates well below that of Indonesia (49%): China (26%), the Philippines (39.3%) and Vietnam (39.7%). These data highlight the fragile status of a large body of Indonesian consumers. Many are one natural disaster away from joining the ranks of the poorest.

The decentralization process is the most important political trend after the institutionalization of democracy. In 2000 government administration of a substantial number of activities was decentralized giving significant control of revenue and limited policy making authority to local officials, and bringing the major economic benefit of a more equitable distribution of government revenues. Jakarta, with about% of the population today, accounted for an

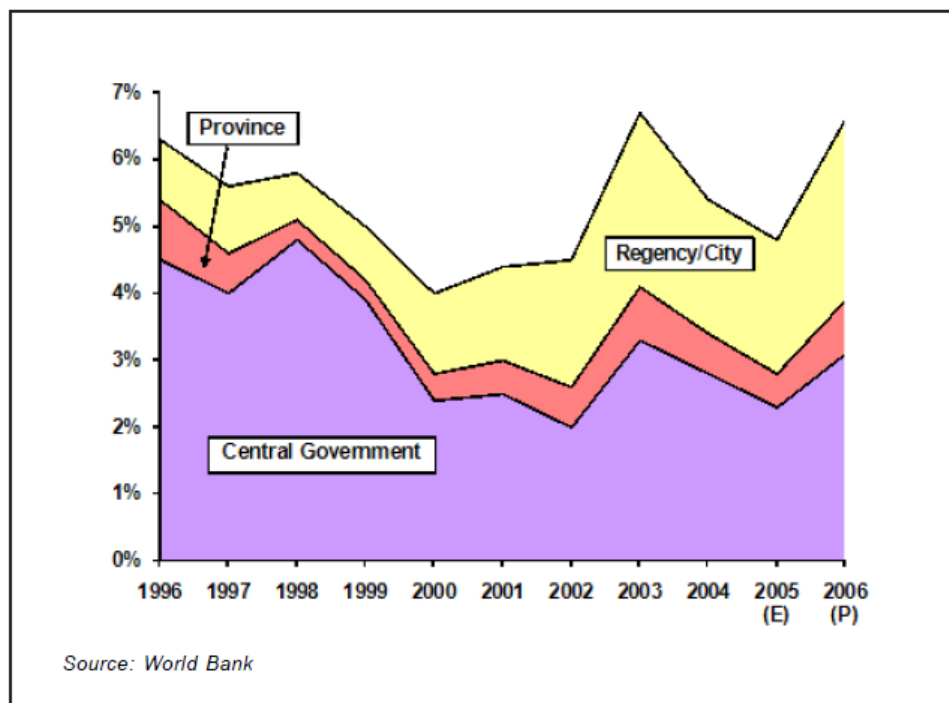
revenues. Jakarta, with about 5% of the population today, accounted for an average of 65 to 70 per cent of both deposits and credits in the banking system prior to the implementation of regional autonomy revenue redistribution. Today Jakarta accounts for just 48% of the deposits and only 36 per cent of the credits. This represents a significant redistribution of wealth from the center to the regions and has taken place without violence or resistance. The result of this wealth transfer has been generally higher investment and growth rates outside of Jakarta. A casual visit to a regional center is sufficient to identify improved well being and infrastructure when compared with the pre-regionalization period. In addition, total Government spending on development (namely, capital spending and social transfers) is estimated to be at, if not above, pre-crisis levels. Public investment as a share of GDP was above 6 percent before the Asian crisis. It fell to below 4 percent in 2000. Currently, spending on development has returned to pre-crisis levels. In 2006, public investment is estimated to have reached above 6 percent of GDP with the improvement in public financial management and decentralization reforms. About half of public investment comes from regions.

**Figure 1.3**  
**PUBLIC INVESTMENT BACK TO PRE-CRISIS LEVEL**



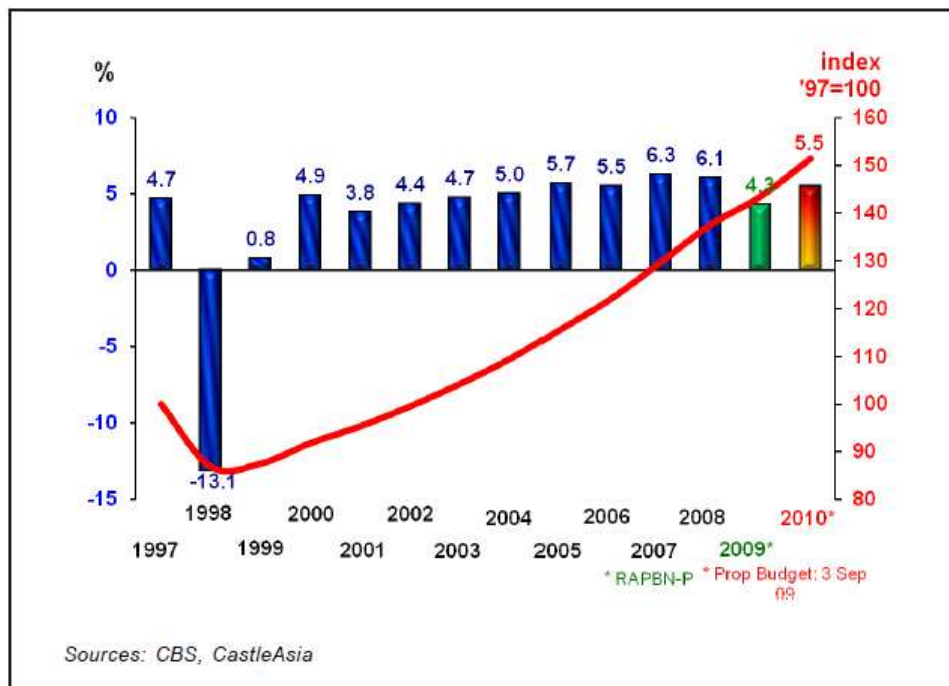
average of 65 to 70 per cent of both deposits and credits in the banking system prior to the implementation of regional autonomy revenue redistribution. Today Jakarta accounts for just 48% of the deposits and only 36 per cent of the credits. This represents a significant redistribution of wealth from the center to the regions and has taken place without violence or resistance. The result of this wealth transfer has been generally higher investment and growth rates outside of Jakarta. A casual visit to a regional center is sufficient to identify improved well being and infrastructure when compared with the pre-regionalization period. In addition, total Government spending on development (namely, capital spending and social transfers) is estimated to be at, if not above, pre-crisis levels. Public investment as a share of GDP was above 6 percent before the Asian crisis. It fell to below 4 percent in 2000. Currently, spending on development has returned to pre-crisis levels. In 2006, public investment is estimated to have reached above 6 percent of GDP with the improvement in public financial management and decentralization reforms. About half of public investment comes from regions.

**Figure 1.3**  
**PUBLIC INVESTMENT BACK TO PRE-CRISIS LEVEL**



Post Asian Crisis growth suffered ups and downs as imbalances were gradually addressed by succeeding administrations. Fuel and power price increases were implemented to relieve budgetary pressures attributable to high levels of subsidies in these commodities. Adjustment of these prices to levels closer to global benchmarks drove a sharp upsurge in inflation (over 15%) and interest rates (up 400 basis points from August to December 2005). However, GDP growth in 2006 was 5.5%, so the economy absorbed the inflationary blow of these actions, and freed budgetary resources for more efficient uses (Figure 1.4).

**Figure 1.4**  
**GDP GROWTH 1997–2010**



Underlying the highly visible strengthening of its democratic institutions, Indonesia has quietly and consistently followed a conservative monetary and fiscal policy path. Although its growth rates are below the recent levels of China and India with which the country is frequently compared, Indonesia's economy performed in step with its Southeast Asian neighbors over the same period. In fact, it has proved to be far more resilient than ASEAN in absorbing the impact of the 2008 Global Crisis. GDP per capita of US\$ 2,100 now exceeds its pre-Asian Crisis high.