Chapter 3

# Regional Economic Developments

# Chapter 3: Regional Economic Developments

At the regional level, economic conditions improved during 2007 with adequately strong growth and relatively stable inflation in some regions. Analyzed by contribution, the economies in the Java, Bali and Nusa Tenggara (Jabalnustra) region and the Jakarta-Banten region provided the strongest driving force for national economic growth. At the same time, brisk economic growth in Kalimantan, Sulawesi, Maluku and Papua (Kali-Sulampua) strengthened that region's contribution to national growth. On the demand side, regional economic growth was generated by vigorous expansion in consumption and exports. Investment growth also gathered momentum, particularly in the mining and plantations sectors. Concerning prices, national inflation was kept stable due to relatively low levels of inflation in some of the most important regions in the national inflation figure. While some regions have made considerable strides in economic performance, substantial disparities in growth and inflation remain. This calls for a common effort for reduction of interregional income disparities.

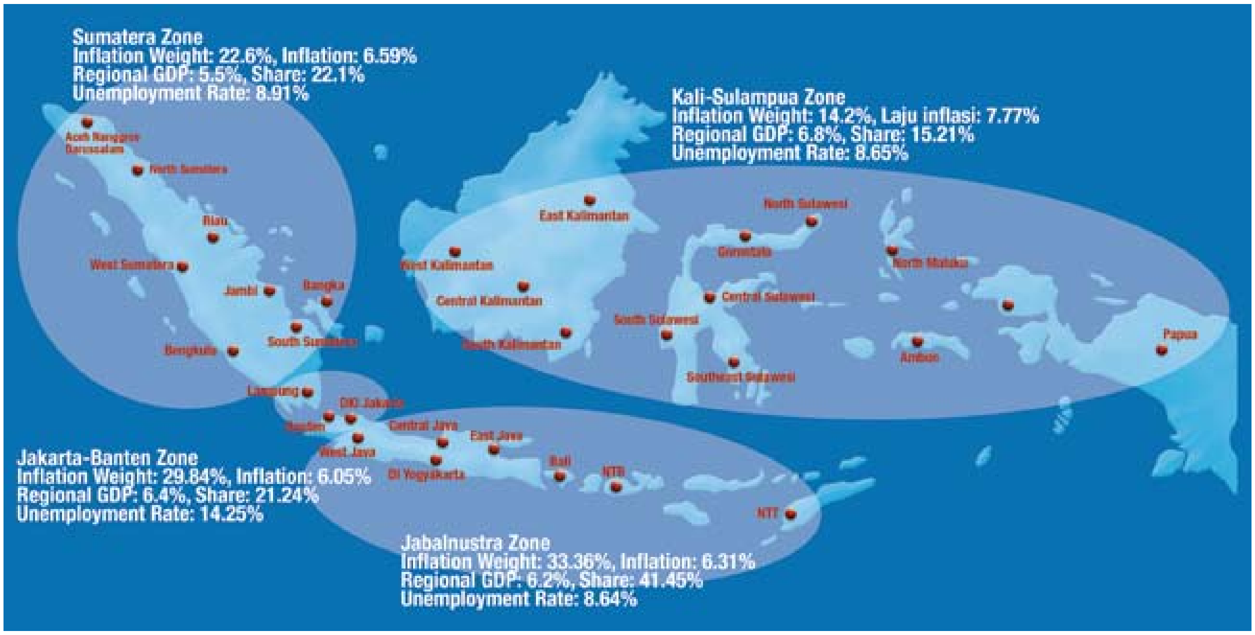
**Economic Performance at the Regional Level**

Regional economies demonstrated improved trends in 2007, reflected in high economic growth and stable inflation in a number of regions. Analysed by contribution, the most important regions for national economic growth were Jakarta-Banten and Jabalnustra. With growth at 6.4% and 6.2%, respectively Jakarta-Banten and Jabalnustra contributed 4.0% of national economic growth. At the same time, the Kali-Sulampua and Sumatera regions took on an expanded role in the growth of the national economy. Kali-Sulampua contributed 1.0% to national growth, following the brisk 6.8% economic growth in that region. Similarly, the Sumatera contribution to national economic growth widened to 1.3%.

On the demand side, consumption again provided the main driving force for growth in all regions. Expanding consumption was fuelled by more robust purchasing power in line with the increase in real incomes. Also key to the high regional growth were mounting exports, particularly in the Kali-Sulampua, Jabalnustra and Jakarta-Banten regions. In Sumatera and Kali-Sulampua, economic growth was also driven by resurgent investment activity.

On the supply side, the major contributing sectors to regional economic growth were trade, manufacturing and agriculture. Growth in the trade and industry sectors was especially strong in Jabalnustra. Further impetus for economic expansion in Jabalnustra, Sumatera and Kali-Sulampua came from growth in the agricultural sector. Despite this, agriculture growth did not fully reflect a fundamental improvement in that sector, given ongoing problems related to the diminishing area of arable land and limited productivity (Box: Agricultural Sector Role in Decline). National economic growth was also supported by robust expansion in the non-oil and gas mining subsector in the Kali-Sulampua region and the communications subsector in Sumatera.

The stable national inflation during 2007 owes much to the low levels of inflation in key contributing regions, most importantly Jakarta-Banten and Jabalnustra. In both regions, low foodstuffs inflation in the absence of distribution problems helped keep overall inflation down. However, some cities registered above national inflation levels. In 2007, inflation surpassed the national average in 25 cities, up from 23 cities in the previous year. Banda Aceh reported the highest inflation for any city (10.44%), while inflation was lowest in Pangkal Pinang (2.60%). The widely varying level of inflation among different cities is explained mainly by differences in foodstuffs and housing inflation. Strong deviation in the two inflation categories is partly the result of supply shocks involving shortages and distribution bottlenecks.




The improving trend in regional economic growth and inflation had a positive impact on prosperity indicators. Unemployment fell in all regions, while per capita incomes increased. The relatively stable inflation, declining unemployment and higher nominal wage levels in some regions produced an overall increase in public purchasing power. Further support for improved purchasing power came from strong price increases for plantation commodities, particularly in regions where the plantations subsector plays a predominant role in the local economy.

Regional economic performance was again marked by growth disparities. The main growth centres have historically been concentrated in Java, with the largest growth contribution generated in Jakarta, followed by West Java and East Java provinces. Economic growth in some provinces lagged behind others, with average growth above 5.95%. These provinces include Aceh, East Kalimantan, West Nusa Tenggara, Bangka Belitung and Riau, where growth was recorded at 0.04%, 2.5%, 3.1%, 3.5% and 4.3%, respectively. Compared to the previous year, the deviation in provincial economic growth widened from 1.7% to 1.8%. One factor explaining the low growth rates in these provinces is limited infrastructure.

Inflation in some regions was again relatively still high, above the national level. In these regions, inflation was spurred by escalating prices in the foodstuffs, processed foods and housing categories caused by supply shocks. Disparities in welfare were also evident with varying per capita income among provinces, particularly between the Jakarta-Banten and Kali-Sulampua regions due to significantly different economic growth levels in provinces.

### Sumatera

Economic growth in the Sumatera region reached 5.5% in 2007, up from the previous year's growth at 4.6%. On the demand side, consumption was the main driving force for growth in this region. Sumatera also recorded significantly increased investment activity, making it a leading region in investment growth. On the supply side, the most important contribution to growth came from the agriculture, trade and construction sectors. Key to this performance was expanding role of bank financing in line with bank credit expansion. Concerning prices, inflation showed a declining trend, despite relatively high inflation in some cities. Lower inflation in Sumatera was the result of falling inflation in the foodstuffs category.

The resurgent economic growth in Sumatera was propelled by higher growth rates in most provinces with growth forging ahead particularly in the southern and central zones of the island (Table 3.1). Analyzed by administrative region, the provinces of North Sumatera, West Sumatera and South Sumatera were the leading contributors to the improved economic performance in the Sumatera region. Higher growth was generated mainly by buoyant performance in the plantations

**Table 3.1**
**Regional GDP Growth in Sumatera**

percent

| | 2005 | 2006 | 2007 |
|---|---|---|---|
| Sumatera Zone | 4.8 | 4.6 | 5.5 |
| North Sumatera | 4.9 | 5.7 | 5.2 |
| Central Sumatera | 4.7 | 4.1 | 5.4 |
| South Sumatera | 4.6 | 4.5 | 5.7 |

Source: Regional BPS-Statistics Indonesia.

**Table 3.2**
**Regional GDP Growth by Expenditure in Sumatera**

percent

| | 2005 | 2006 | 2007 |
|---|---|---|---|
| Sumatera Zone | | | |
| Consumption | 4.9 | 5.1 | 6.0 |
| Gross Fixed Capital Formation | 6.3 | 6.1 | 8.2 |
| Net Exports | 4.6 | 4.1 | 5.1 |

Source: Regional BPS-Statistics Indonesia.

subsector, which represents one of the primary growth engines in the two provinces. Other provinces, notably Aceh and Riau, recorded only low growth due to sluggish performance in the mining sector and specifically in the oil and natural gas subsector, the main source of growth in both provinces. At the same time, Aceh has received only limited stimulus for the local economy from the post-tsunami rehabilitation and reconstruction. There, the ongoing rehabilitation and reconstruction programme has not fully functioned as a force for turning the wheels of the local economy.

On the demand side, more vibrant economic growth in the Sumatera region was driven by consumption and investment (Table 3.2). Consumption mounted considerably during 2007. Increased household consumption followed improvement in farmer terms of trade and real increases in the provincial minimum wage in most provinces (Chart 3.1 and 3.2). Gross fixed capital formation advanced at a brisk pace in Sumatera. Key to investment growth was improvement in infrastructure, such as the construction and repair work to the eastern Sumatera highway, as well as redoubled investment in plantations. Sumatera also reported more robust export growth during 2007 on the strength of mounting demand for plantation commodities, such as crude palm oil (CPO) and derivative products, in addition to rubber and rubber products (Chart 3.3).

Disaggregated by sector, the most important contribution to growth in Sumatera came from the agriculture, trade and construction sectors. Agriculture sector growth forged ahead at a brisk clip during 2007, driven by robust growth in the plantation subsector (rubber and palm oil). One factor boosting rubber and palm oil production was the expansion of land under cultivation for estate crops. In addition, soaring world rubber and CPO prices spurred efforts to boost output of palm oil and rubber. In the trade sector, higher growth was closely linked to more vigorous consumption and growth in trade-related sectors, including construction and industry. Among factors prompting renewed construction growth was the post-tsunami reconstruction programme and expansion of land under cultivation for oil palm estates.

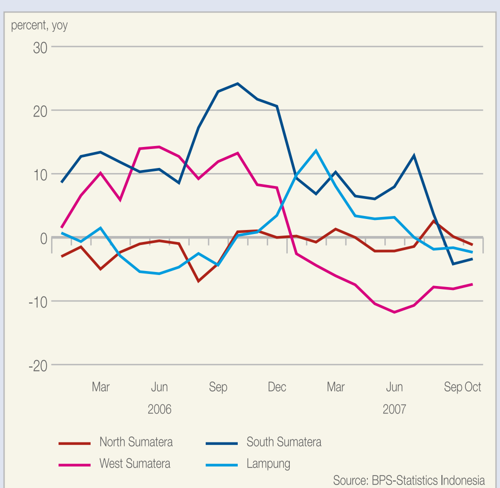



**Chart 3.1**
**Farmers Terms of Trade Growth in Sumatera**

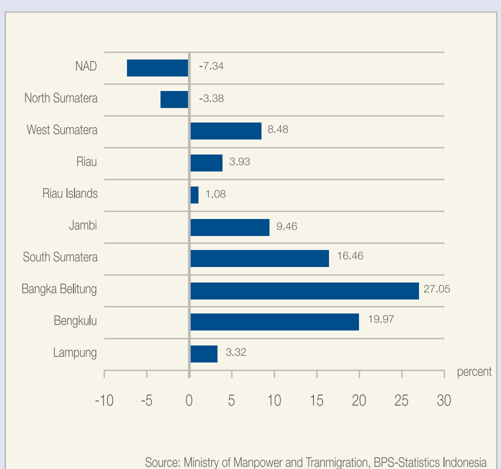



**Chart 3.2**
**Real Provincial Minimum Wage Growth in Sumatera 2007**

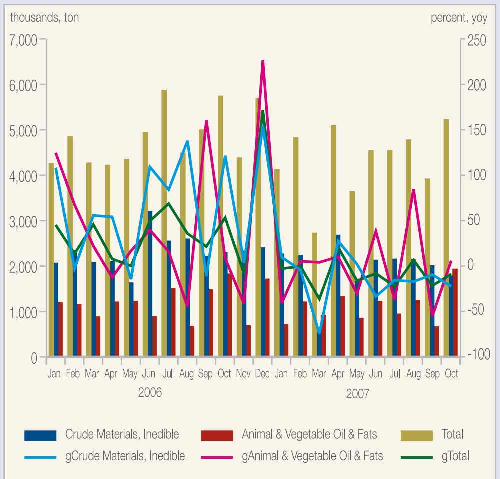



**Chart 3.3**
**Main Export Commodities in Sumatera (SITC)**

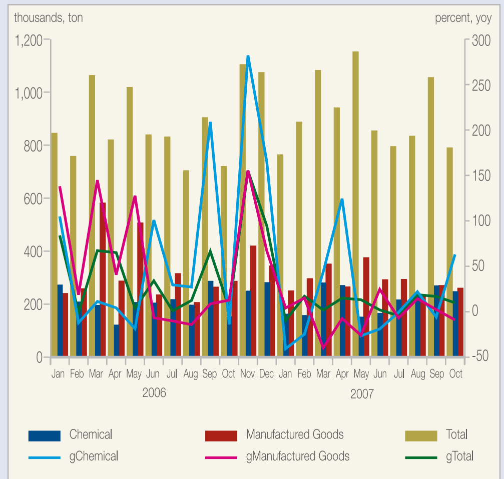



**Chart 3.4**
**Main Imports Comodities in Sumatera (SITC)**

Opportunity for economic advancement in the Sumatera region has come with the enactment of the Act on the Batam-Bintan-Karimun Free Trade Zone (FTZ-BBK) in October 2007. Under this act, the islands of Batam, Rembang and Galang are designated free trade zones in their entirety, while Bintan and Karimun are designated as enclave zones. With the Free Trade Zone in force, accelerated economic activity and employment will not benefit only the Riau Islands province, but also nearby areas through multiplier effects leveraging the economic interdependencies among these regions. Another factor supporting economic advancement in Sumatera is financing. Banks operating in the Sumatera region have steadily improved their performance with depositor funds reaching Rp203.2 trillion, up 19.6% from the preceding year. Depositor funds are almost evenly divided among demand deposits, saving deposits and time deposits. Loan disbursements are also on the rise. Lending in 2007 climbed to Rp127.2 trillion, representing 28.6% expansion over the year before. The steep rise in credit compared to depositor funds has strengthened bank performance, reflected in improvement in the Loan to Deposit Ratio (LDR) (Table 3.4).

In regional fiscal management, the absorption rate in regional budgets in the Sumatera region remains on the lower end of the scale. In Aceh province, budget absorption reached Rp1.4 trillion, or 35.4% of the Rp4.0 trillion budget ceiling[1]. In the provinces of South Sumatera, Bangka Belitung and Lampung, locally-generated revenues and regional expenditure realization averaged more than 70%. The low absorption rate is explained by several different factors, including the delay of launching of Regional Government projects in the year.

Inflation in the Sumatera region reached 6.95% in 2007, lower than in the preceding year. The falling inflation in Sumatera is explained by a drop in foodstuffs inflation. However, in regions such as North Sumatera and South Sumatera (Chart 3.5 and 3.6), inflationary pressures persisted as a result of supply shocks, which were reflected in high volatile foods inflation. Inflation in Sumatera, as in previous years, surpassed the national average. Seven out of 14 cities in the Sumatera region recorded above national levels of inflation. In the city of Banda Aceh, inflation reached 10.44%, the highest level for any city in Indonesia. Sumatera is heavily dependent on goods supplied from outside the island and between provinces on Sumatera itself, and the island is highly susceptible to price shocks because of lack of improvement in infrastructure.

### Jakarta-Banten Region

In 2007, the Jakarta-Banten region charted 6.4% economic growth, unchanged from the previous year. On the demand side, consumption played a role as

1 November 2007.

**Table 3.3**
**Regional GDP Growth by Sector in Sumatera**

percent

| | 2005 | 2006 | 2007 |
|---|---|---|---|
| Sumatera Zone | | | |
| Agriculture | 2.4 | 2.2 | 4.3 |
| Mining & Quarrying | 1.6 | 1.6 | 1.5 |
| Manufacturing | 4.6 | 4.0 | 4.4 |
| Electricity, Gas & Water | 5.9 | 5.8 | 3.3 |
| Construction | 8.3 | 7.0 | 7.3 |
| Trade, Hotels, & Restaurants | 6.8 | 9.0 | 7.1 |
| Transportation & Communication | 9.7 | 9.7 | 10.2 |
| Finance, Rental | 7.0 | 7.7 | 8.2 |
| Services | 4.7 | 5.0 | 8.7 |

Source: Regional BPS-Statistics Indonesia

the main driving force for growth in this region. On the supply side, the most important contributions to growth came from trade, financial services and construction. In regard to financing, economic performance was underpinned by more rapid bank credit expansion alongside relatively high realization of regional budget. Inflation in the Jakarta-Banten region eased in comparison to 2006. Additionally, Jakarta-Banten inflation was below the national average. Lower inflation was recorded in almost all categories of goods and services.

On the demand side, economic growth in Jakarta-Banten was supported by rising consumption and investment (Table 3.5). Factors spurring increased

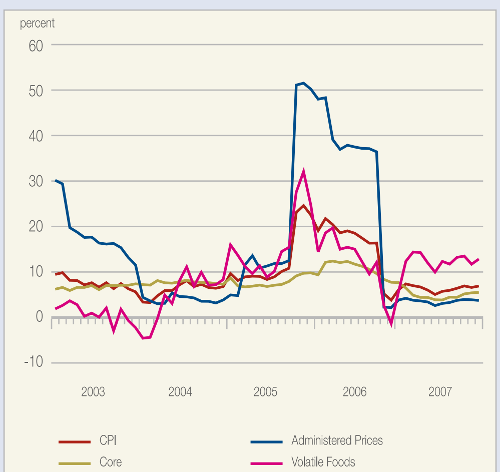
**Table 3.4**
**Banking Indicators in Sumatera**

| | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|
| **Depositor Funds** | | | | |
| Position (Rp Trillions) | 118.1 | 135.5 | 173.2 | 203.2 |
| Growth (%) | 15.7 | 19.9 | 21.9 | 19.6 |
| Demand Deposits (Rp Trillions) | 28.1 | 40.2 | 56.5 | 62.6 |
| Savings Deposits (Rp Trillions) | 52.6 | 50.9 | 61.7 | 74.8 |
| Time Deposits (Rp Trillions) | 37.5 | 44.4 | 55.0 | 65.8 |
| **Credit (total)** | | | | |
| Position (Rp Trillions)** | 68.5 | 84.8 | 100.9 | 127.2 |
| Growth (%) | 29.2 | 25.9 | 17.4 | 28.6 |
| Working Capital (Rp Trillions) | 30.9 | 39.7 | 47.6 | 61.3 |
| Investment (Rp Trillions) | 16.8 | 19.2 | 22.6 | 26.0 |
| Consumption (Rp Trillions) | 20.8 | 25.9 | 30.7 | 39.9 |
| MSMEs (Rp Trillions)*** | 44.2 | 57.3 | 69.0 | 86.0 |
| Loan to Deposit Ratio | 57.6 | 60.5 | 58.2 | 62.6 |
| Non Performing Loan Ratio | 2.4 | 6.8 | 5.8 | 4.7 |

** based on distributor bank location
*** based on project location

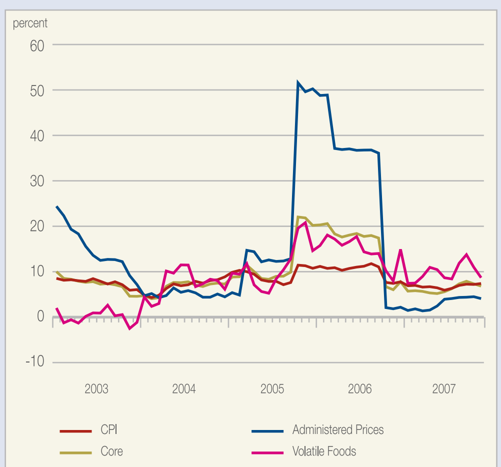
consumption were improvement in public purchasing power, particularly for middle and upper income earners, and public expectations of improvement in the economy. Investment recorded increased growth with brisk construction of property and transportation infrastructure in Jakarta and nearby areas.

On the supply side, economic growth in the Jakarta-Banten region was driven by trade, financial services




Source: BPS-Statistics Indonesia

**Chart 3.5**
**Core and Non-Core Inflation in North Sumatera**




Source: BPS-Statistics Indonesia

**Chart 3.6**
**Core and Non-Core Inflation in North Sumatera**

**Table 3.5**
**Regional GDP Growth by Expenditure in Jakarta-Banten**

percent

| | 2005 | 2006 | 2007 |
|---|---|---|---|
| Consumption | 6.5 | 6.7 | 7.2 |
| Gross Fixed Capital Formation | 5.2 | 4.4 | 5.6 |
| Exports | 8.6 | 9.4 | 5.6 |
| Imports | 5.6 | 4.2 | 11.4 |

Source: Regional BPS-Statistics Indonesia

and construction. Growth in the trade sector was consistent with mounting consumption. Reflecting the stronger performance in trade was the volume of loading and unloading at the ports of Tanjung Priok, Banten and Sunda Kelapa. In the financial sector, resurgent growth in credit and depositor funds improved bank performance. Vibrant growth in the construction sector was fuelled by property and transport infrastructure development.

In the Jakarta-Banten region, bank performance reached new heights in 2007. Depositor funds mounted to Rp725.7 trillion, an increase of 13.6% over the preceding year. Time deposits comprised the largest share of bank funding at Rp401.8 trillion, or 55.4% of total depositor funds. Loan disbursements were also up 26.4%, bringing total credit outstanding to Rp503.8 trillion. Improved banking performance in 2007 was also reflected in the stronger LDR and falling NPLs (Table 3.7).

Regional fiscal management in 2007 was marked by quite high realization rates in regional budgets for Jakarta and Banten provinces. In Jakarta, realized capital expenditures at the end of 2007 stood at 81.7% of budget allocations, significantly improved from the outcome one year before. Nevertheless, the largest share of realized budget expenditures was recorded in recurrent expenditures at 87.4%. In the province of Banten, realized capital expenditures in 2007 reached 87.8% of budget, down from the 2006 outcome.

Inflation in Jakarta-Banten eased to 6.05% for 2007 from the 2006 level of 6.15% in response to falling inflation in the foodstuffs and housing categories. One factor contributing to reduced inflation was the plentiful supply of goods to Jakarta, including rice and cooking oil. Inflation in the Jakarta-Banten region was below the national inflation rate.

**Table 3.6**
**Regional GDP Growth by Sector in Jakarta-Banten**

percent

| | 2005 | 2006 | 2007 |
|---|---|---|---|
| Jakarta-Banten Zone | | | |
| Agriculture | 2.3 | 2.4 | 1.2 |
| Mining & Quarrying | 1.6 | 0.4 | 2.2 |
| Manufacturing | 5.8 | 5.5 | 4.3 |
| Electricity, Gas & Water | 5.6 | 5.1 | 2.4 |
| Construction | 6.0 | 7.6 | 8.1 |
| Trade, Hotels & Restaurants | 7.1 | 6.3 | 7.9 |
| Transportation & Communication | 11.2 | 12.7 | 14.1 |
| Finance, Rental | 4.7 | 4.3 | 5.4 |
| Services | 5.6 | 5.2 | 6.6 |

Source: Regional BPS-Statistics Indonesia

### Java-Bali-Nusa Tenggara (Jabalnustra)

Economic growth in the Java, Bali and Nusa Tenggara (Jabalnustra) region reached 6.2% in 2007, well ahead of the previous year's growth of 5.4%. Demand-side growth was fuelled mainly by consumption. On the supply side, growth impetus came from the heavyweight sectors of trade, agriculture and manufacturing. Availability of financing in the Jabalnustra region improved through bank credit expansion that arrived at 20.9%, while regional budget realization in some provinces also improved over the preceding year. Inflation in Jabalnustra was down in comparison to 2006 and also below the national inflation rate. The downward trend is a result of

**Table 3.7**
**Banking Indicators in Jakarta-Banten**

| | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|
| **Depositor Funds** | | | | |
| Position (Rp Trillions) | 529.8 | 582.5 | 628.7 | 725.7 |
| Growth (%) | 8.2 | 16.9 | 5.0 | 13.6 |
| Demand Deposits (Rp Trillions) | 146.8 | 160.1 | 175.9 | 200.6 |
| Savings Deposits (Rp Trillions) | 95.6 | 85.9 | 99.2 | 123.3 |
| Time Deposits (Rp Trillions) | 287.4 | 336.4 | 353.5 | 401.8 |
| **Credit (total)** | | | | |
| Position (Rp Trillions)** | 299.7 | 356.1 | 409.5 | 503.8 |
| Growth (%) | 26.4 | 24.0 | 8.1 | 26.4 |
| Working Capital (Rp Trillions) | 158.0 | 190.0 | 225.8 | 275.6 |
| Investment (Rp Trillions) | 74.7 | 83.0 | 93.4 | 114.1 |
| Consumptions (Rp Trillions) | 67.0 | 83.1 | 90.4 | 114.2 |
| MSMEs (trillions Rp)*** | 63.5 | 85.2 | 97.8 | 131.7 |
| Loan to Deposit Ratio | 57.2 | 60.6 | 62.4 | 69.4 |
| Non Performing Loan Ratio | 6.0 | 8.7 | 6.8 | 4.9 |

** based on distributor bank location
*** based on project location

**Table 3.8**
**Development and Realization of Regional State Budget in Jakarta-Banten**

Rp billions

| Descriptions | Budget 2006 | Realization up to Q4-2006 | % | Budget 2007 | Realization up to Q4-2007 | % |
|---|---|---|---|---|---|---|
| **DKI Jakarta** | | | | | | |
| Locally - Generated Revenues | 8,666.7 | 7,771.8 | 89.7 | 10,084.3 | 8,819.8 | 87.5 |
| Primary Balance | 6,661.0 | 6,459.9 | 97.0 | 7,572.1 | 7,445.9 | 98.3 |
| Administration & Operational Expenditures | 11,974.8 | 10,993.4 | 91.8 | 13,929.1 | 12,171.8 | 87.4 |
| Capital Expenditures | 5,828.2 | 4,348.6 | 74.6 | 6,142.7 | 5,019.3 | 81.7 |
| **Banten** | | | | | | |
| Locally - Generated Revenues | 1,126.4 | 1,118.0 | 99.3 | 1,306.9 | 1,306.2 | 99.9 |
| Primary Balance | 480.1 | 465.4 | 96.9 | 590.7 | 574.3 | 97.2 |
| Administration & Operational Expenditures | 7,021.5 | 651.5 | 92.9 | 828.6 | 626.8 | 75.6 |
| Capital Expenditures | 396.7 | 390.1 | 98.3 | 443.2 | 389.2 | 87.8 |

declining inflation in almost all categories of goods and services.

The accelerated growth in Jabalnustra is powered mainly by West Java province, which enjoys the highest growth rate and is also the most important contributor to growth in Jabalnustra overall. The East Java zone ranked second as an engine of growth, followed by the Central Java zone. The robust growth in the three zones of Java is an indication that flooding on the island has not significantly impacted economic growth in the Jabalnustra region.

On the demand side, household consumption and exports again provided the economic growth momentum in the Jabalnustra region. Increased consumption came on the back of rising purchasing power commensurate with the real increase in the provincial minimum wage in all provinces (Chart 3.9) and stronger farmer terms of trade in Central Java, East Java, Bali and West Nusa Tenggara provinces (Chart 3.10). Exports forged ahead in West Java, led by textiles and textile products profiting from sharply ascending foreign demand.

Disaggregated by sector, the primary sources of economic growth in the Jabalnustra region are trade,

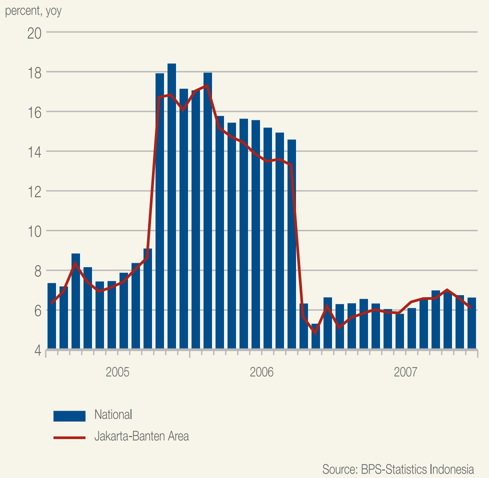



**Chart 3.7**
**Inflation of Jakarta-Banten Area**

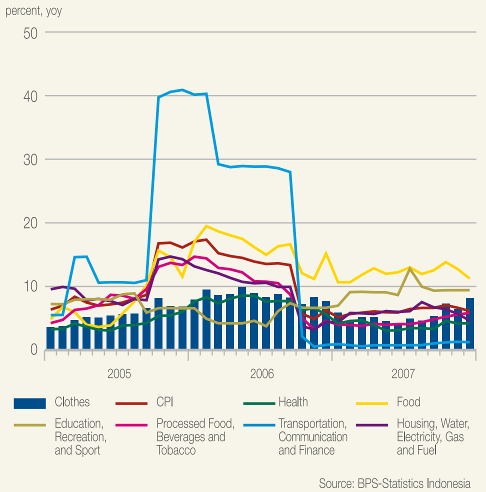
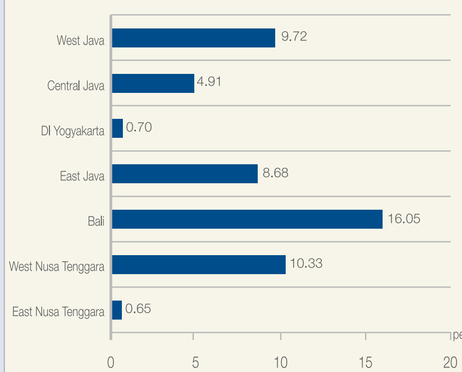
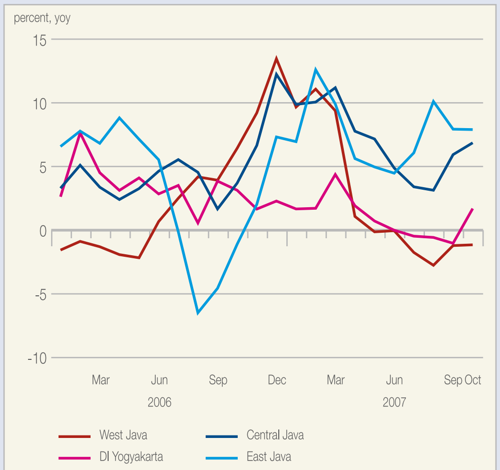



**Chart 3.8**
**Inflation of Jakarta-Banten Area**




Source: Ministry of Manpower and Transmigration, BPS-Statistics Indonesia

**Chart 3.9**
**Real Provincial Minimum Wage Growth of Jabalnustra in 2007**




Source: BPS-Statistics Indonesia

**Chart 3.10**
**Farmers Term of Trade Growth in Jabalnustra**

agriculture and manufacturing. Growth picked up in the trade sector in line with rising consumption. One indication of performance in this sector was the heavier volume of goods transported out of the Jabalnustra region. In agriculture, growth resulted from higher production of rice and corn, both leading agricultural commodities in this region (Table 3.10), as a result of improved productivity. Climate change and flooding had little effect on agricultural performance in Jabalnustra. Alongside this, stronger performance was reported in manufacturing, also one of the mainstay sectors of Jabalnustra. In the West Java zone, manufacturing growth was bolstered by strong performance in the transportation equipment, machinery and textiles and textile products subsectors. In the East Java zone, manufacturing growth was recorded mainly in the food, beverages and tobacco subsector, as well as the paper and printed goods subsector. In the Central Java zone, manufacturing sector performance was driven by vigorous growth in the oil and gas refining subsector on the back of increased output at the Cilacap refinery and a number of oil drilling blocks.

**Table 3.9**
**Regional GDP Growth in Jabalnustra**

percent

| | 2005 | 2006 | 2007 |
|---|---|---|---|
| Jabalnustra Zone | 5.6 | 5.4 | 6.2 |
| West Java Zone | 5.6 | 6.0 | 6.4 |
| Central Java Zone | 5.3 | 5.2 | 5.5 |
| East Java Zone | 6.0 | 5.8 | 6.0 |

Source: Regional BPS-Statistics Indonesia.

Bank performance in the Jabalnustra region showed steady improvement in 2007. Depositor funds reached Rp373.1 trillion at end-2007, an increase of 13%. At Rp149.8 trillion, time deposits represented the most important component of bank funding (40.1% of the total). Similarly, loan disbursements came to Rp245.7 trillion, following 20.9% expansion, with working capital credit accounting for the largest share. Improved bank performance was also evident in the more robust LDR and falling NPLs ratio in the Jabalnustra region.

**Table 3.10**
**Paddy and Corn Production in Java and Non-Java**

| | 2005 | 2006 | 2007 | Growth 2007 (%) |
|---|---|---|---|---|
| **PADDY** | | | | |
| Production (thousands ton) | | | | |
| Java | 29,767.0 | 29,961.0 | 30,628.7 | 2.2 |
| Non Java | 24,389.6 | 24,495.6 | 26,413.9 | 7.8 |
| Indonesia | 54,156.5 | 54,456.6 | 57,042.6 | 4.7 |
| **CORN** | | | | |
| Production (thousands ton) | | | | |
| Java | 7,455.0 | 6,689.0 | 7,457.4 | 11.5 |
| Non Java | 5,068.7 | 4,921.3 | 5,822.0 | 18.3 |
| Indonesia | 12,523.7 | 11,610.3 | 13,279.4 | 14.4 |

Source: BPS-Statistics Indonesia
* ARAM III

**Table 3.11**
**Banking Indicators in Jabalnustra**

| | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|
| **Depositor Funds** | | | | |
| Position (Rp Trillions) | 265.1 | 278.7 | 324.5 | 373.1 |
| Growth (%) | 3.4 | 15.1 | 13.8 | 13.0 |
| Demand Deposits (Rp Trillions) | 54.2 | 57.6 | 68.0 | 78.9 |
| Savings Deposits (Rp Trillions) | 109.8 | 105.4 | 123.9 | 144.4 |
| Time Deposits (Rp Trillions) | 101.0 | 115.7 | 132.5 | 149.8 |
| **Credit (total)** | | | | |
| Position (Rp Trillions) ** | 150.8 | 185.9 | 207.0 | 245.7 |
| Growth (%) | 24.1 | 25.1 | 10.3 | 20.9 |
| Working Capital (Rp Trillions) | 80.8 | 99.4 | 113.0 | 131.5 |
| Investment (Rp Trillions) | 17.8 | 20.1 | 21.9 | 25.7 |
| Consumption (Rp Trillions) | 52.2 | 66.5 | 72.1 | 88.5 |
| MSMEs (Rp Trillions)*** | 128.9 | 168.1 | 191.4 | 206.1 |
| Loan to Deposit Ratio | 58.4 | 63.5 | 61.6 | 65.9 |
| Non Performing Loan Ratio | 2.9 | 4.6 | 5.0 | 4.3 |

** based on distributor bank location
*** based on project location

Regional fiscal management in Jabalnustra was marked by generally improved realization in 2007 regional budgets compared to the previous year. In the province of West Java, realized direct expenditure components reached more than 90% of budget allocations. This high rate of realized expenditure is explained by implementation of development projects mainly for improvement of local government offices and infrastructure. In Central Java, spending was dominated by personnel expenditures at 51.9%, while capital expenditures for public services accounted for only 10.9% of the total (Table 3.12).

The Jabalnustra region was also marked by falling inflation, below even the national inflation figure. The decline in inflation came in response to lower prices for rice and other foodstuffs. Adequate supply and smooth distribution of staple needs in the region were among the key factors easing foodstuff inflation.

### Kalimantan, Sulawesi, Maluku and Papua (Kali-Sulampua)

The year 2007 saw brisk economic growth in the Kalimantan, Sulawesi, Maluku and Papua (Kali-Sulampua) region, albeit with strong inflation. Growth in Kali-Sulampua reached 6.8%, ahead of other regions. On the demand side, growth was driven by consumption, exports and investment. Analysed by sector, the largest contributions to growth came from trade and agriculture. On the other hand, the Kali-Sulampua region sustained a high rate of inflation at 7.77%, significantly higher than the national inflation

**Table 3.12**
**State Expenditures Realization in Central Java**

Rp billions

| Description | 2007 | | | |
|---|---|---|---|---|
| | Quarter I | Quarter II | Quarter III | Quarter IV |
| 1 Personnel Expenditures | 2,123.92 | 2,407.30 | 2,501.19 | 2,658.47 |
| 2 Material Expenditures | 423.81 | 706.49 | 720.59 | 724.56 |
| 3 Official Travel Expenditures | 64.95 | 100.81 | 104.75 | 104.75 |
| 4 Maintenance Expenditures | 141.31 | 242.75 | 252.22 | 235.49 |
| 5 Other Expenditures | 1.27 | 1.27 | 1.30 | 1.40 |
| 6 Capital Expenditures | 149.75 | 296.26 | 444.39 | 546.24 |
| 7 Profit Sharing and Financial Assistance Expenditure | 217.49 | 683.54 | 615.19 | 724.68 |
| 8 Unexpected Expenditures | 0.00 | 133.04 | 140.89 | 128.80 |
| **Total** | **3,122.51** | **4,571.44** | **4,780.50** | **5,124.3** |
| Distribution (percentage) | | | | |
| 1 Personnel Expenditures | 68.02 | 52.66 | 52.32 | 51.88 |
| 2 Material Expenditures | 13.57 | 15.45 | 15.07 | 14.14 |
| 3 Official Travel Expenditures | 2.08 | 2.21 | 2.19 | 2.04 |
| 4 Maintenance Expenditures | 4.53 | 5.31 | 5.28 | 4.60 |
| 5 Other Expenditures | 0.04 | 0.03 | 0.03 | 0.03 |
| 6 Capital Expenditures | 4.80 | 6.48 | 9.30 | 10.66 |
| 7 Profit Sharing and Financial Assistance Expenditure | 6.97 | 14.95 | 12.87 | 14.14 |
| 8 Unexpected Expenditures | 0.00 | 2.91 | 2.95 | 2.51 |
| **Total** | **100.00** | **100.00** | **100.00** | **100.00** |

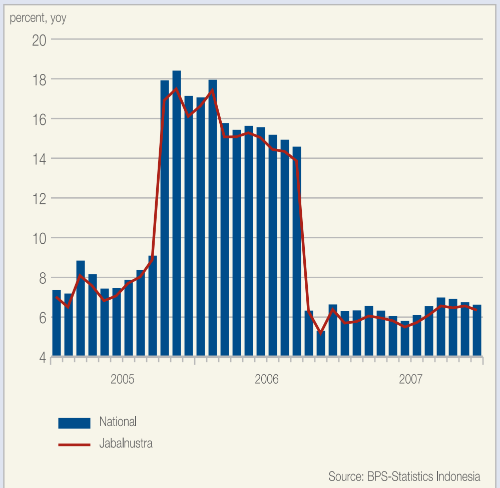



**Chart 3.11**
**Inflation of Jabalnustra Area**

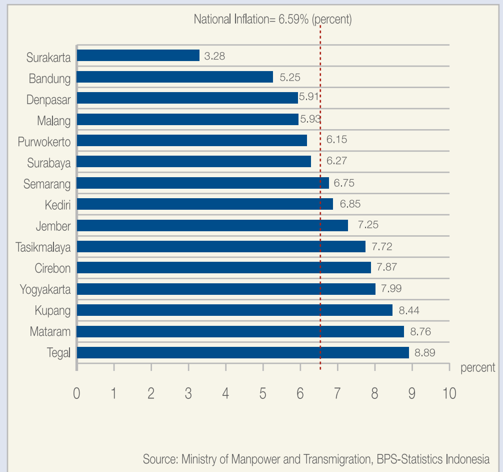



**Chart 3.12**
**Inflation of Jabalnustra Area by Cities in 2007**

rate. This inflation was driven by escalating prices for consumer goods, with foodstuffs and housing prices most affected.

The economy in Kali-Sulampua recorded significant growth in 2007. Driving this performance was robust economic growth in the Sulampua region at 11.1%. In contrast, Kalimantan recorded only moderate growth at 3.8%. Most provinces in the Sulampua zone were high growth performers, with the exception of North Maluku and Maluku provinces where growth reached 5.2% and 5.1%, respectively. In the provinces of South Kalimantan and East Kalimantan in the Kalimantan zone, growth was similarly low at 5.3% and 2.5%, respectively. The modest growth in East Kalimantan and South Kalimantan is explained by slowing performance in the mining sector.

On the expenditure side, household consumption, exports and investment were the main growth factors in the Kali-Sulampua region. Growth in household consumption was buoyed by strengthened public purchasing power, reflected in the increased provincial minimum wage levels and farmer terms of trade in some provinces (Chart 3.13 and 3.14). Farmer terms of trade in Kali-Sulampua improved in response to rising plantation commodity prices. Exports in the region also mounted higher in line with the upward trend in exports of primary commodities, such as coal, rubber and CPO, fuelled by vibrant demand on the domestic and international market. Alongside this, investment gathered momentum particularly in the plantations and mining sectors and in construction of rail links for transporting coal.

Analysed by sector, the main sources of growth were trade and agriculture, while mining, one of the primary sectors in Kali-Sulampua, contributed relatively little. Growth in trade was spurred by rising consumption and performance in trade-linked sectors. Agriculture sector performance improved, buoyed by increased production in the foodcrops and plantations subsectors. Key to this was expansion of cultivated land and improved productivity levels. At the same time, the mining and quarrying sector reported higher growth compared to the previous year. Mining sector growth picked up in the Sulawesi zone with higher levels of nickel ore and gold production following the expansion in underground mining operations by Papua's largest mining company.

Banks charted performance gains in the Kali-Sulampua region. Bank funds mobilisation reached Rp132.9 trillion, with savings deposits comprising the largest share at Rp55.4 trillion or 41.7% of total depositor funds. At the same time, loan disbursements reached Rp77.5 trillion, dominated by consumption credit. Improved banking performance was reflected in the steady rise in the LDR. Added to this, NPLs recorded

**Table 3.13**
**Regional GDP Growth in Kali-Sulampua Zone**

percent

| | 2005 | 2006 | 2007 |
|---|---|---|---|
| Kali-Sulampua Zone | 5.5 | 6.2 | 6.8 |
| Kalimantan Zone | 3.9 | 3.7 | 3.8 |
| Sulawesi Zone | 8.1 | 9.9 | 11.1 |

Source: Regional BPS-Statistics Indonesia

decline, although the NPLs ratio in the Kali-Sulampua region was the highest compared to other regions (Table 3.14).

Regional fiscal management was marked by strong performance in local government budget realization. In East Kalimantan province, realized local government budgets at end of year reached 80%. In Central Kalimantan, regional budget realization were at 64% of 2007 budgets. Budget administration and excessively long tendering processes are two factors hampering budget realization.

Inflation mounted significantly in the Kali-Sulampua region in 2007, climbing above the national inflation rate. Rising inflation was spurred by price movements in the foodstuffs, housing and transportation categories. Inflation in 12 out of the 14 cities in the Kali-Sulampua region surpassed the national inflation rate. The high rate of inflation is explained by supply shortages in parts of the Kali-Sulampua region due to difficulties with distribution and dependence on supply from other regions and especially from Java. Reflecting this were high rates of volatile foods inflation in some cities, including Banjarmasin (Chart 3.15) and Manado (Chart 3.16).

## Regional Demographics

Stronger economic growth and stable inflation in most regions helped bring gradual improvement in the prosperity of the local population. Regional unemployment levels eased alongside improvement in per capita income. Welfare also improved in response to a series of Government programmes, including the Askeskin health insurance scheme for impoverished families and operational assistance for schools (BOS). Despite this, the regions have not undergone a significant improvement in welfare, as evident in the relatively small drop in unemployment and poverty levels and the continued income disparities among regions.

**Table 3.14**
**Banking Indicator in Kali-Sulampua Zone**

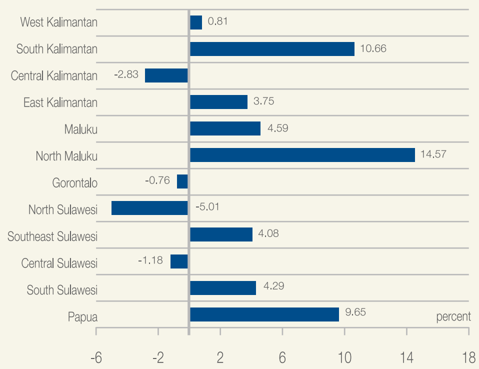
| | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|
| **Depositor Funds** | | | | |
| Position (Rp Trillions) | 75.6 | 85.4 | 111.0 | 132.9 |
| Growth (%) | 16.3 | 20.6 | 25.7 | 20.7 |
| Demand Deposits (Rp Trillions) | 16.8 | 23.0 | 36.7 | 42.2 |
| Savings Deposits (Rp Trillions) | 39.5 | 39.2 | 49.1 | 55.4 |
| Time Deposits (Rp Trillions) | 19.3 | 23.2 | 25.3 | 35.3 |
| **Credit (total)** | | | | |
| Position (Rp Trillions) ** | 43.4 | 52.6 | 62.0 | 77.5 |
| Growth (%) | 39.2 | 24.0 | 16.4 | 27.5 |
| Working Capital (Rp Trillions) | 17.2 | 20.5 | 24.9 | 31.6 |
| Investment (Rp Trillions) | 8.2 | 9.8 | 11.2 | 12.7 |
| Consumption (Rp Trillions) | 18.0 | 22.3 | 25.9 | 33.2 |
| MSMEs (Rp Trillions)*** | 33.9 | 43.3 | 51.3 | 64.5 |
| Loan to Deposit Ratio | 58.0 | 59.7 | 55.2 | 58.3 |
| Non Performing Loan Ratio | 2.7 | 7.1 | 6.1 | 6.0 |

** based on distributor bank location
*** based on project location

Labor conditions in the regions saw improvement during 2007. Labor intake was up in all regions in line with economic growth at the local level. The highest increase in employed workers was recorded in the Sumatera region, followed by Java and Sulawesi (Table 3.15). However, the higher numbers of workers entering employment was not followed by significant reductions in unemployment, with intake of workers insufficient to offset the growth in the workforce. In Jakarta-Banten, Java, Sumatera and Sulawesi, unemployment remains high. However, unemployment levels are low in Bali, Nusa Tenggara, Kalimantan, Maluku, Papua and Sumatera, and also below the national average.

With stronger regional economic growth and low population growth[2], per capital incomes have improved. Per capita income was up in all regions, with highest levels recorded in Jakarta and East Kalimantan (Chart 3.17). However, this improvement was still marred by regional income disparities, particularly between Jakarta-Banten and Kali-Sulampua. These disparities are the result of several factors, including different rates of economic growth and population growth.

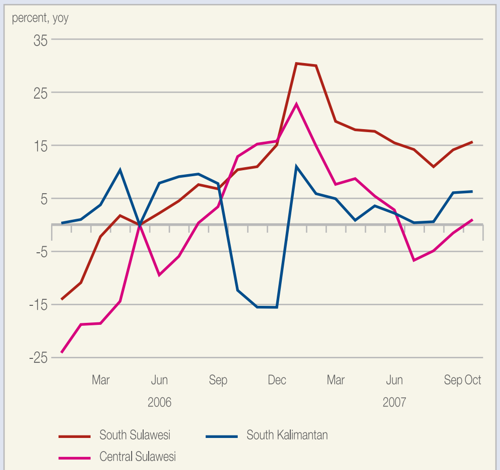
2 Source: Key Socio-Economic Indicators for Indonesia, March 2007, BPS.




Source: Ministry of Manpower and Transmigration, BPS-Statistics Indonesia

**Chart 3.13**
**Real Provincial Minimum Wage Growth in Kali-Sulampua in Year 2007**

10



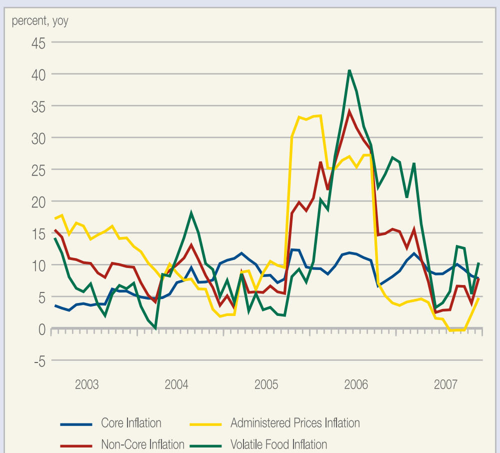

Source: BPS-Statistics Indonesia

**Chart 3.14**
**Farmers Term of Trade Growth of Kali-Sulampua**

Higher rates of economic growth and greater employment have helped ease poverty levels. In 2007, the number of population living in poverty was down in all regions compared to 2006. The steepest fall in numbers of poor was recorded in the Sumatera region (8.1%), followed by Jakarta-Banten (6.0%) (Chart 3.18). However, this reduction carried less significance, as indicated by the relatively unchanged proportion of population in poverty to the populations of individual regions.

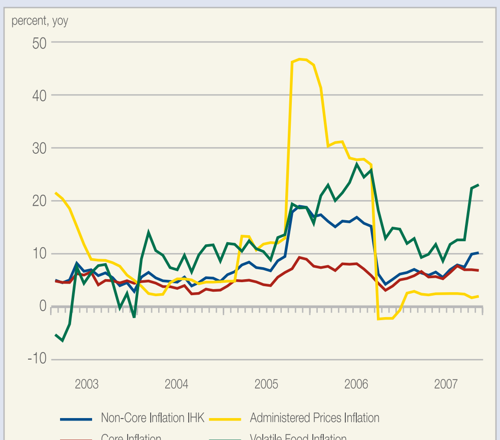
## Regional Economic Issues

Regional economies continue to be daunted by various problems, including regional disparities in economic growth and the growing number of cities reporting inflation above the national average. These two problems have led to disparities in quality improvement in regional economies. Nevertheless, these issues will be gradually addressed through improvements to infrastructure and inter-agency coordination.




Source: BPS-Statistics Indonesia

**Chart 3.15**
**Core and Non-Core Inflation of South Kalimantan**




Source: BPS-Statistics Indonesia

**Chart 3.16**
**Core and Non-Core Inflation of North Sulawesi**

Table 3.15
**Employment and Unemployment Rate by Region**

| | Labor (millions of people) | | Employment (millions of people) | | Unemployment Rate (%) | |
|---|---|---|---|---|---|---|
| | August 2006 | August 2007 | August 2006 | August 2007 | August 2006 | August 2007 |
| Sumatera | 21.08 | 21.66 | 18.95 | 19.73 | 10.10 | 8.91 |
| Jabalnustra | 61.72 | 64.15 | 55.74 | 58.61 | 9.69 | 8.64 |
| Java (non Jakarta-Banten) | 55.59 | 57.91 | 49.99 | 52.67 | 10.07 | 9.05 |
| Bali and Nusa Tenggara | 6.13 | 6.24 | 5.75 | 5.94 | 6.20 | 4.81 |
| Jakarta-Banten | 8.29 | 8.42 | 7.05 | 7.22 | 14.96 | 14.25 |
| Kali-Sulampua | 15.26 | 15.72 | 13.71 | 14.36 | 10.16 | 8.65 |
| Kalimantan | 6.10 | 6.13 | 5.53 | 5.67 | 9.34 | 7.50 |
| Sulawesi | 7.00 | 7.35 | 6.21 | 6.62 | 11.29 | 9.93 |
| Papua and Maluku | 2.16 | 2.24 | 1.97 | 2.07 | 8.80 | 7.59 |
| Indonesia | 106.39 | 109.94 | 95.46 | 99.93 | 10.28 | 9.11 |

Source: BPS-Statistics Indonesia

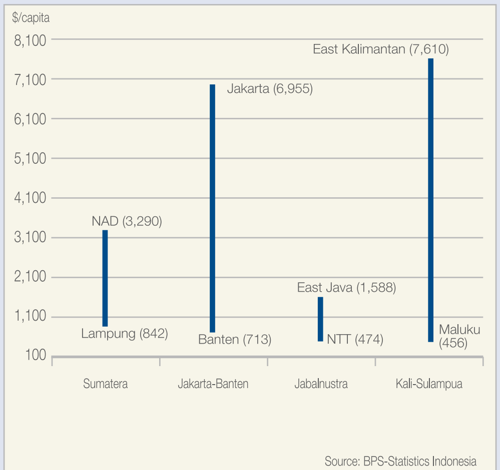



**Chart 3.17**
**Regional GDP per Capita by Region**

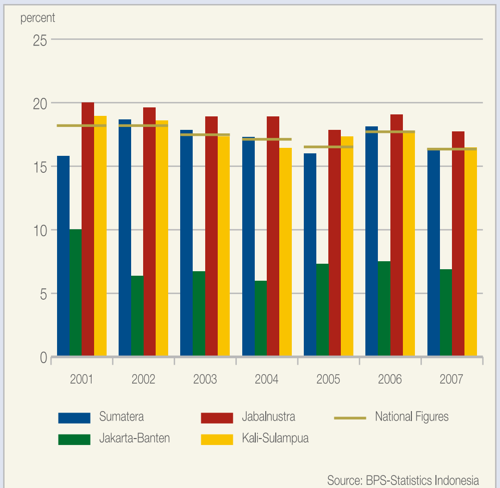



**Chart 3.18**
**Poverty Rate of Regional Citizen**

The national economy is overwhelmed by disparities in regional economic growth, with the steepest differences occurring in the Kali-Sulampua and Sumatera regions. GDP growth in some of these provinces is well below the national growth rate. Even in some resource-rich regions, notably Aceh, Riau, Papua and East Kalimantan, growth is below the national average. Compared to the previous year, the deviation in economic growth among provinces widened from 1.7% to 1.8%. Reasons for the sluggish growth performance in some regions include limited infrastructure, regional regulations that discourage investment and overwhelming dependence of the local economy on one particular primary sector (mining).

Inflation in most cities in Indonesia is above the national inflation rate. According to observations over the past 4 years, 34 cities recorded inflation above the national rate. In these cities, inflation is fuelled mainly by escalating inflation in the foodstuffs, processed foods and housing categories. One underlying cause of high inflation in these regions is the problem of supply shocks on the market for goods (Box: Inflation Control in the Regions). These supply shocks are caused by such problems as supply shortages, poor infrastructure for distribution, long span of distribution, hoarding, charging of illegal levies and seasonal influence.

# Regional Inflation: Issues and Control Measures

Low, stable inflation is a prerequisite for sustainable economic growth. When inflation is low and stable, economic agents are able to engage in economic activity on a more carefully measured basis. Producers can set more affordable selling prices, while consumers are able to obtain needed goods appropriate to the purchasing power. Stable inflation and the sustainable economic growth that it supports also help to boost prosperity levels in the long-term, as indicated in more robust public purchasing power, greater absorption of manpower and stronger private incomes. These conditions also help to improve the quality of life for the local population, as envisaged in the mission for regional governments in the Medium-Term Development Plan.

National CPI inflation represents the aggregate movement in prices of goods and services in 45 cities across Indonesia. Analysed by weighting on a per city basis, Jakarta is the largest contributor to national inflation. However, if analysed by region, all regions have a sizeable weighting in the national inflation rate (Table 1).

Urban inflation figures for the past 4 years show that 34 cities almost consistently report inflation above the national CPI inflation rate. The high rate of inflation in these cities is fuelled mainly by escalating inflation in the foodstuffs, processed foods and housing categories. Analysis of causative factors reveals a consistent pattern in urban inflation, with the main source of inflationary pressure coming from fundamentals (exchange rate pressure, high expectations and output gap) and administered prices. However, the behavior of price movements in the regions can be specifically differentiated by supply and distribution of goods, which can give rise to different levels of supply shocks in individual areas. Shocks are attributable to various causes, including supply shortages, poor distribution infrastructure, long distribution lines, hoarding, illegal levies and seasonal influence.

**Table 1**
**Inflation Weight by Cities**

| Sumatera | | Jakarta-Banten | | Jabalnustra | | Kali-Sulampua | |
|---|---|---|---|---|---|---|---|
| Lhokseumawe | 0.25 | Jakarta | 27.66 | Tasikmalaya | 0.7 | Pontianak | 1.36 |
| Banda Aceh | 0.66 | Serang/Cilegon | 2.18 | Bandung | 6.76 | Sampit | 0.26 |
| Padang Sidempuan | 0.31 | | | Cirebon | 0.87 | Palangkaraya | 0.52 |
| Sibolga | 0.24 | | | Purwokerto | 0.69 | Banjarmasin | 1.93 |
| Pematang Siantar | 0.68 | | | Surakarta | 1.58 | Balikpapan | 1.31 |
| Medan | 5.98 | | | Semarang | 4.36 | Samarinda | 1.55 |
| Padang | 2.07 | | | Tegal | 0.83 | Manado | 1.27 |
| Pekanbaru | 1.95 | | | Yogyakarta | 1.22 | Palu | 0.68 |
| Batam | 1.72 | | | Jember | 0.92 | Makassar | 3.06 |
| Jambi | 1.31 | | | Kediri | 0.86 | Kendari | 0.5 |
| Palembang | 3.98 | | | Malang | 2.05 | Gorontalo | 0.46 |
| Bengkulu | 0.76 | | | Surabaya | 8.9 | Ternate | 0.32 |
| Bandar Lampung | 2.25 | | | Denpasar | 1.94 | Ambon | 0.58 |
| Pangkal Pinang | 0.44 | | | Mataram | 1.07 | Jayapura | 0.4 |
| | | | | Kupang | 0.61 | | |
| **Total** | **22.6** | **Total** | **29.84** | **Total** | **33.36** | **Total** | **14.2** |

The creation of stable CPI inflation is the task and responsibility of Bank Indonesia. To fulfil this responsibility, Bank Indonesia formulates monetary policy on the basis of the inflation targeting framework. Within this framework, the central bank influences inflation on the fundamentals side, particularly in order to shape public expectations. However, on the non-fundamentals side, Bank Indonesia is unable to influence inflation given that administered prices are the competence of the Government and supply shocks are determined by availability of supply and smooth distribution. In the post-regional autonomy era, regional governments play a central role in issues related to supply and distribution. For this reason, control of supply shocks demands close attention from Bank Indonesia through efforts to strengthen cooperation between the Government and regional institutions concerned with addressing problems in the production and distribution of goods and policy formulation. Inflation control in the regions involves collaborative action with local stakeholders using multiple approaches as follows: a. Reinforcement of institutional linkages between Bank Indonesia at the regional level and local governments, most importantly for building a common commitment among the relevant parties to curbing inflation in the region, given the common need for low, stable inflation; b. identification of reasons for shortages of staple needs in the region, with the strategic goal of ensuring the smooth distribution of staple goods, shortening distribution lines, improving regional infrastructure and eradicating hoarding practices and illegal levies; c. holding dissemination activities to build public awareness among the local population of the condition and outlook for the economy and risks of inflationary pressure.

On the institutional side, Bank Indonesia will work for more effective cooperation with regional governments through the BI Regional Offices. Two forms of cooperation will be developed and put into action in 2008 through optimization of Focus Group Discussions (FGDs) and establishment of the Regional Inflation Control Teams (TPID). The objective of the strengthened institutional arrangements is to convey concerns over inflationary pressure in individual regions and communicate actions for mitigating these pressures. The focus of inflation control at the regional level is three-fold: (i) ensuring adequate supply; (ii) minimizing price shocks arising from regional regulations (user charges and taxes); and (iii) building understanding of the condition and outlook of the economy and the risks of inflationary pressure at the regional level.

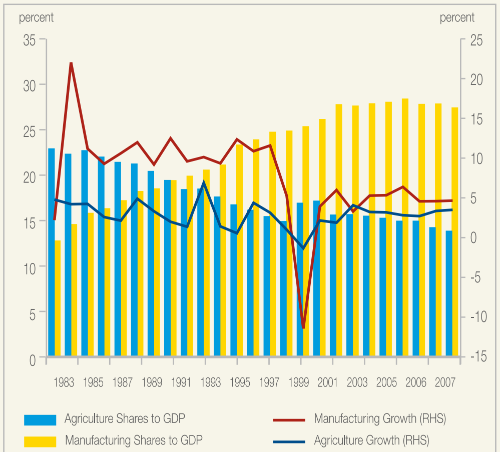
# Agricultural Sector Role in Decline

Over the past 20 years, the role of agriculture as an engine for the economy has been in declining trend. This is borne out in the diminishing share of agriculture in the national economy, down from about 20% in 1990 to only about 15% (Chart 1). The declining role is explained by the more modest growth of the agricultural sector, with the slowdown most apparent in the food crops subsector. Commodities in the food crops subsector include rice, corn, wheat and potatoes. Within this subsector, the most important crop is rice.

Growth in paddy production has tapered off during the past 20 years (Chart 2). This slowing growth is explained by rice production in Java, which has fallen behind production growth in other areas. Java is the most important centre for paddy cultivation in Indonesia, accounting for 57.6% of the national crop, followed by Sumatera and Sulawesi at 22% and 9%, respectively.

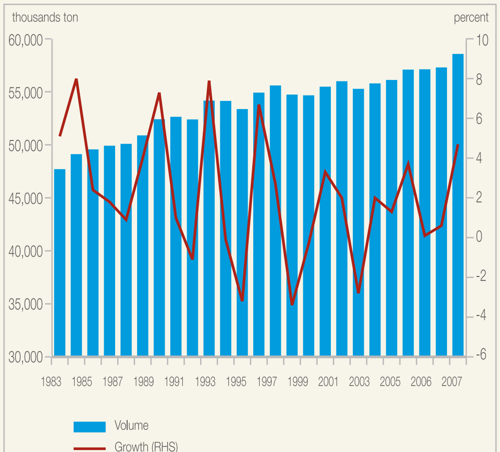
Two factors are responsible for slow rate of growth in paddy cultivation: low productivity and loss of arable land. The low productivity has several causes, ranging from the deteriorating condition of agricultural infrastructure to the still limited use of seed technology and poor procurement and distribution of fertilizers and agricultural chemicals. Agricultural infrastructure networks have deteriorated significantly with 17.5% of networks damaged or unusable (Table 1). The most serious damage has been sustained in irrigation networks and water reservoirs. The distribution system for labelled seeds is unable to guarantee quality control and crops yields are therefore below optimum levels despite farmer attempts to cultivate crops with the use of these labelled seeds. Fertiliser shortages have emerged because of limited domestic production caused by decline in capacity (Chart 3). Indonesia also suffers from loss of land used for paddy cultivation, particularly in Java due to conversion of rice paddies to other use (Chart 4).

The diminishing role of agriculture portends a decline in the supply of foodstuffs and employment. Indonesia's growing population and limited rice production




Source: BPS-Statistic Indonesia

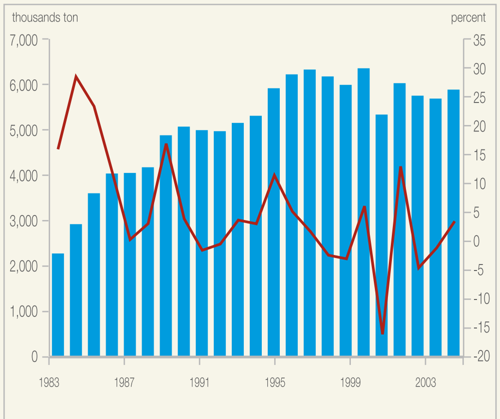
**Chart 1**
**Agriculture and Manufacturing Share and Growth**




Source: BPS-Statistic Indonesia

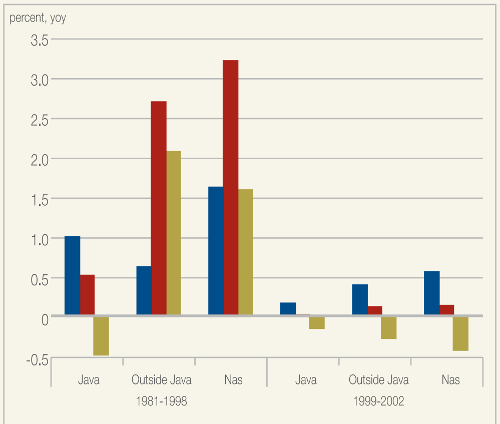
**Chart 2**
**Paddy Production Volume and Growth**

underscores the necessity of rice imports to secure food supplies (Table 2). Indonesia has imported rice every year except for a brief period of self-sufficient rice production in 1993. Concerning employment, the low rate of growth in agriculture also means a low rate of absorption of workers in this sector. This is very unfortunate, given that agriculture is a very important source of employment for the population.



Source: BPS-Statistic Indonesia

**Chart 3**
**Urea Production Volume and Growth**



Source: Ministry of Agriculture

**Chart 4**
**Area Conversion of Paddy, 1981-2002**

**Table 1**
**Condition of Irrigation Infrastructure**

| Infrastructure Constructed | Quantity | Units | Condition | | Water Supply Reliability | |
|---|---|---|---|---|---|---|
| | | | Heavy Damage | Light Damage | Reservoir | Non-Reservoir |
| Irrigation Network | 6,771.83 | km | 341.33 (0.05%) | 1,178.55 (17.4%) | 719.17 (10.62) | 6,052.65 (89.38) |
| Dam | 1,154 | location | 1 (0.24%) | – | – | – |
| Reservoir | 273 | location | 14 (5.1%) | 5 (1.8) | – | – |

Source: Ministry of Agriculture