No. 8/ /PSHM/Humas

PRESS RELEASE

STATEMENT BY THE GOVERNOR OF BANK INDONESIA
Bank Indonesia Lowers BI Rate 25bps

In the Board of Governor's Meeting held today, July 6, 2006, **Bank Indonesia decided to lower the BI Rate by 25 basis points (bps) to 12.25%**. This decision was adopted after an evaluation of Indonesia's macroeconomic conditions and the outlook for the economy and monetary conditions, taking into account the ongoing achievement of the 8%±1% inflation target for 2006.

In the assessment of the Board of Governors, macroeconomic stability steadily improved during the period ending June 2006, as indicated by the downward trend in inflation and easing of external pressures. With the June inflation of 0.45%, the year to date inflation (January-June) had been kept in check at 2.87% though the year-on-year inflation (June 2006 against June 2005) was recorded at 15.53%. The present downward trend in inflation is the result of overall stability and appreciation in the exchange rate, minimum impact from administered prices, and persistent weak domestic demand. Specific sources of inflationary pressure in Q2/2006 were rising gold prices, higher official retail prices for cigarettes, and water billing rates.

In the view of the Board of Governors' Meeting, Indonesia's economic growth is below expectations. Growth in Q2/2006 is estimated at 4.6%-5.1%, with driving force coming mainly from a substantial rise in exports. The slowing growth performance is explained mainly by weak domestic demand, which has been affected by lack of recovery in public purchasing power. Reflecting this is continued decline in real wage levels, lack of improvement in the investment climate, and relatively low multiplier effects from government spending. Household consumption and private investment are estimated to have expanded 3%-3.5% and 1.4%-1.9%, down from the same quarter in the preceding year. The low rate of economic growth and investment has also constrained demand for credit, which in January-May 2006 expanded at only 2.4%. Exports of goods and services are estimated to have climbed 11.8%-12.3%, largely on the back of strong export growth in minerals and manufactured products, such as palm oil, rubber, and paper, buoyed by rising world demand. Estimated government spending for the first half of 2006, however, reached only 33% of the national budget. Based on these developments, overall economic growth for 2006 is predicted to be on the lower end of the 5.0%-5.7% projected range.

The balance of payments surplus for Q2/2006 reached an estimated $3.3 billion, surpassing the earlier forecast. This improvement in the Q2/2006 surplus took place mainly in the current account as a result of more robust export performance that contrasted with import growth below forecasted levels. The capital and financial account recorded another surplus at US$2.17 billion despite capital reversal in the middle of May 2006. Following the US$3.8 billion accelerated repayment of part of the debt owing to the IMF on June 30, 2006, international reserves were down slightly from the preceding quarter to about US$40 billion, equivalent to 4.5 months of imports and servicing of official debt.

Despite the positive trend in the balance of payments, the continued tightening cycle in the global economy, particularly with the hike in the Fed Funds rate, led to **mounting pressure on macroeconomic stability in Q2/2006**. In mid-May 2006, the rupiah began to weaken against the US dollar. Nevertheless, calculated as an average, the rupiah still gained during Q2/2006 at Rp 9,111 to the US dollar, representing about 2% appreciation over Q1/2006. This strengthening in the rupiah was accompanied by reduced volatility.

In the banking sector, banking system performance began to improve in the second quarter, in line with earlier predictions. Almost all major banking indicators for the period pointed to heartening progress. In May 2006, depositor funds were up Rp 37.4 trillion with expansion in banking assets at Rp 48 trillion. At the same time, overall credit risk showed an encouraging trend with the NPLs net ratio easing to 5.1% from 5.6% in April 2006. Similarly, NPLs gross fell to 8.8% from 9.4% in April 2006.

Looking ahead, CPI inflation for 2006 and 2007 is estimated within the targeted ranges at 8±1% and 6±1% (yoy). Nevertheless, some external and internal risks can not be entirely ruled out that might lead to escalating pressures on the exchange rate and CPI inflation in both 2006 and 2007. Externally, these risks primarily concern high oil prices and the potential for further increases in global interest rates. These risks may have some bearings due to the forex structure, which is in part comprised short-term capital inflow while long-term supply of foreign currency remains limited. Internally, risks primarily arise from the potential for inflationary pressure from administered prices in relation to government plans to raise the floor price for unhusked rice and transport fares, mainly for economy class rail travel.

After taking account of achievement of the inflation target, which remains on track, the Bank Indonesia Board of Governors' Meeting decided today to **lower the BI Rate to 12.25%**. This monetary policy stance will be reviewed from time to time in line with the comprehensive assessment of developments and forecasts for inflation and the economy. If there is further easing in future inflationary pressure and the risks confronting the economy, more aggressive reductions will be made in the BI Rate. The present 25 bps cut in the BI Rate is expected to strengthen business confidence for improvement in the economic outlook, which will be vital to reducing unemployment. Given that this interest rate is followed by various measures to implement the policy package for improvement of the investment climate and accelerated disbursement of government capital expenditures, Bank Indonesia views that the second half of 2006 will augur well with optimism for improved economic growth.

Jakarta, July 6, 2006
Directorate of Strategic Planning
And Public Relations

Budi Mulya
Director